September 1958

THE CANADIAN CHARTERED ACCOUNTANT

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS


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THE CANADIAN
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DEPARTMENTS

MONTHLY FEATURES

The Canadian Chartered Accountant, September 1958. Published monthly by the Canadian Institute of Chartered Accountants. Chairman, Editorial Board, H. S. Moffet, F.C.A.; Editor, Renny Englebert; Asst. Editor, Jean Vale. Advertising Representative, E. L. Vetter. Editorial and business office: 69 Bloor street east, Toronto 5. Subscription rates: $6 a year; 60 cents a copy. Printed by General Printers Limited and mailed at Oshawa, Ontario. Authorized as second class mail by the Post Office Department, Ottawa. Opinions expressed are not necessarily endorsed by the Canadian Institute.

IN THIS ISSUE

A. E. STEAD, C.A. (page 220)

The article "Trust Administration and Control" is a look behind the scenes to see what is involved in a well-run and well-controlled trust corporation. The author takes the reader, in a non-technical way, through the various procedures and stages concerned with the disposition of an estate and shows how the duties of a trustee are exacting, detailed and highly responsible. Although Mr. Stead's article deals primarily with trust administration in relation to estates, the reader will also find his discussion on pension and bond trusteeship of special interest.

Mr. Stead has been associated with Chartered Trust Company since 1948. He joined the firm as internal auditor a year after obtaining his certificate in chartered accountancy and, in 1949, was appointed comptroller. Two months ago, he was made associate secretary while retaining his former position. He is a member of the Institute of Chartered Accountants of Ontario and also a regional vice-president of the Institute of Internal Auditors.

F. H. FRITZ (page 231)

The way to obtain faster and fuller information in business is a comparatively common topic of conversation today among businessmen and, while there is no simple answer to the question, Francis H. Fritz, in his article "Criteria for Evaluating Punched Card Applications", suggests a solution to data processing improvement which may have appeal in many situations. His study of the subject illustrates that the mere acquisition of punched card equipment will not solve data processing problems. The test lies in analyzing the work to be performed and determining all the relevant operational procedures before any installation is made.

Before joining the management advisory services of Price Waterhouse & Co., Montreal in 1957 as a director, Mr. Fritz was associated for seven years with Remington-Rand Limited as sales manager for tabulating and electronic equipment. He is a graduate of Acadia University and did post-graduate studies at Yale University. He is the author of various articles on the application of machine and electronic methods to the processing of business data.

WILLIAM ROBSON (page 215)

In "The Securities Market in the Canadian Economy", an experienced executive in the field of investment takes a look at the history and development of the securities market in Canada. William Robson, a vice-president of A. E. Ames & Co., forecasts that, while the growth of the securities market will be slower than that experienced during the past decade, it will be a sounder one.

Mr. Robson has spent most of his life in the investment business. He joined Ames & Co. in 1923 and has served in executive capacities in the company's Montreal and Vancouver offices. In 1949, he was elected a director and, in 1957, a vice-president of the company. He is currently chairman of the Secondary Marketing Committee for the $6.4 billion 1958 Canada Conversion Loan, a supplementary trading department assisting the Bank of Canada in this largest re-investment program in Canada's history.

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J. A. McCLELLAND, C.A. (page 237)

In "Tax Status of a Foreign Corporation in Canada", John A. McClelland says that the Canadian Income Tax Act looks most favourably on capital invested in companies conducting mining operations, companies defined as foreign business corporations and non-resident-owned investment corporations. This theme runs through much of the author's discussion on tax liabilities of a foreign corporation doing business in Canada. A significantly large amount of new investment has been and is being financed by non-resident investors, particularly in the United States and, to a lesser extent, in the United Kingdom. Mr. McClelland's article is an attempt to stimulate thinking on the tax factors affecting those foreign companies doing business or investing in Canada, a subject which will be of growing importance as the nation continues to expand.

Mr. McClelland is a partner in the firm of McDonald, Currie & Co., Toronto, with whom he has been associated since 1949. He received his certificate in chartered accountancy from the Ontario Institute in 1953.

J. G. McDONALD, LL.M. (page 226)

Many accountants are called upon from time to time to discuss the tax implications of carrying on a business as a partnership. In "The Taxation of Partnership Income", John G. McDonald is critical of the Income Tax Act as it relates to the subject of partnerships and suggests that the Department of National Revenue is developing adminstrative practices to meet situations that are ignored by the statute. "My own feeling", he told the Editor, 'is that, if the statute is intended to state the law clearly, it ought not to leave such a wide area open to the vagaries of assessing practice and departmental discretion which too often is inconsistently applied to suit the interests of the revenue in particular cases."

Mr. McDonald is a member of the legal firm of McCarthy & McCarthy, Toronto. He is the author of "Canadian Income Tax" and "Cases and Materials on Income Tax" and contributes a column entitled "Your Taxes" to *The Financial Post*. He is a special lecturer in taxation at Osgoode Hall Law School and a member of the British Columbia and Ontario Bars.

DAVID P. CRAWLEY, C.A. (page 243)

The second article in the series on "The Small Store" deals with methods of merchandise control and is of key importance to the small retailer who must be concerned with safeguarding his stock from various forms of loss and maintaining it at adequate but not excessive levels. The distinctive conditions that vitally affect retail accounting procedure largely centre around merchandise control and so the problem inevitably arises of how best to keep purchasing within the limits fixed in the budget and relate it to sales, particularly where slow-selling merchandise has to be taken into account. Mr. Crawley's article deals with these and other problems under the sub-title "Merchandising Control".

The author is a partner of Arthur A. Crawley & Co., Ottawa, and has been associated with several of the company's Ontario offices. He is a member of the Institute of Chartered Accountants of Ontario and obtained his certificate in chartered accountancy in 1936.

NOTES AND COMMENTS

C.I.C.A. Annual Report 1958

The report of The Canadian Institute of Chartered Accountants for the year ending April 30, 1958 is now being mailed to all members of the Institute. Highlights of the report are reviewed in this issue's editorial on pages 213-214.

Magazine Committee

Under the chairmanship of Harold S. Moffet, F.C.A., Montreal, the Magazine and Publications Committee has been formed for 1958-59. Its members are J. W. Beech, Montreal; Yves-Aubert Cote, Montreal; C. K. MacGillivray, Hamilton; G. H. Peck, Montreal; R. E. Saunders, Toronto; D. G. Scott, Toronto; J. L. Smith, Toronto.

New Publications

To promote a better understanding of the procedures in trading and securities a new brochure on "Canada's Investment Business" is being published by the Canadian Institute later this month. It will contain articles by the presidents of the Toronto and Montreal Stock Exchanges, the chairman of the Ontario Securities Commission and other well known leaders in the financial field. Most of the articles have appeared in *The Canadian Chartered Accountant* in recent months. Priced at $1.75 each ($1.50 each for quantities of 25 or more), copies may now be ordered from the Institute.

"An Approach to Selected Business Problems" is the title of another group of articles now published in brochure form by the Canadian Institute. Topics included are capital financing for a growth program, reviving a declining business, a program for executive development, pension planning and branch accounting at both the wholesale and retail levels. The booklet is available from the C.I.C.A. at $1.25 ($1.00 for orders of 25 or more).

Internal Audit Conference

The 1958 North East Regional Conference of the Institute of Internal Auditors will take place at the Royal York Hotel, Toronto, on October 30 and 31. Under the theme "A Day in the Life of An Internal Auditor", papers and panel discussions will deal with report writing, selection of audit personnel, audit manuals, fraud, relationship of the internal auditor to management and public accountants, capital works programs and audit of "tab" operations.

All chartered accountants in the Toronto area will receive conference program details by mail early in September. Further data may be obtained from L. V. Carter, Canadian Oil Companies Ltd., 188 University Ave., Toronto.

Automobile Facts

In 1957 Canadians put 36.8 billion miles on the speedometers of their

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cars, compared with 33.6 billion miles in 1956 and 15:1 billion miles ten years ago. The latest edition of "Facts and Figures of the Canadian Automotive Industry" issued by the Canadian Automobile Chamber of Commerce shows that 3.4 million passenger cars and one million trucks were registered last year. There is now a vehicle in Canada for every 3.7 persons and a passenger car for every 4.9 persons. Approximately one out of every three Canadians holds a driver's licence.

English Institute Elections

The Institute of Chartered Accountants in England and Wales has elected as its president for 1958-59 William L. Barrows, J.P., F.C.A. of Birmingham. Its vice-president is Charles U. Peat, M.C., M.A., F.C.A. of London.

NAA Elections

John B. Inglis, a partner in Price Waterhouse & Co., New York, has been elected president of the National Association of Accountants for 1958-59. He was elected at the annual meeting of the association at the Conrad Hilton Hotel, Chicago.

American Institute Bulletin

Companies which use a rapid write-off method to compute depreciation charges for tax purposes should either use the same basis for financial reporting purposes or else recognize the taxes being deferred by providing for the taxes that will have to be paid when the benefits of accelerated depreciation have expired, according to a revised bulletin issued by the American Institute of Certified Public Accountants. The bulletin reverses a position taken by the American Institute Committee on Accounting Procedure in 1954 when it declared that it was not necessary to give accounting recognition to these deferred taxes.

In Parliament

Canada-Belgium Tax Agreement

On July 16 Parliament passed Bill No. C-28 to implement a convention between Canada and Belgium for the avoidance of double taxation with respect to income tax. The agreement follows the pattern established in other recent income tax agreements which Canada has made with the U.S., U.K., Sweden, Ireland, New Zealand and other countries.

* * *

Adjustment Payments Taxable?

From Hansard, July 23: L. R. Crouse (Queens-Lunenburg): Mr. Speaker, may I direct a question to the Minister of National Revenue. Is the adjustment payment made to bondholders on reconversion subject to income tax?

Hon. George S. Nowlan (Minister of National Revenue): Mr. Speaker, this adjustment payment to bondholders on reconversion has an element of interest in it; that is, part of the payment involves interest which has accrued on the bond, another part is entirely independent of the interest. In so far as the interest element is concerned, that is taxable in the hands of the holder of the bond, who in fact will be required when he surrenders the bond for conversion to sign an ownership certificate indicating the proportion of interest accrued thereon.

Editorial

THE INSTITUTE YEAR

THE REPORT of The Canadian Institute of Chartered Accountants for the year ended April 30, 1958, which is now being circulated to members, clearly indicates that another year of progress has been achieved. The total membership has risen to 7,979, an increase of 539 during the twelve-month period and the number of registered students totals 4,537 compared to 4,233 at the same time last year. Competition for high calibre students remains keen and ways to attract and train sufficient of them to meet the growing needs of practising firms and the expanding requirements of industry continue to be of general concern to the profession.

This month a new executive is to be elected, and the retiring president, Mr. James A. de Lalanne, can look back on a term of office which, at high cost to him in time and energy, has brought great credit to the profession in Canada. He has had a strenuous year and travelled more than 30,000 miles, an impressive figure even in this age of supersonic jets and comets. In September, he flew to Amsterdam to attend and speak at the Seventh International Congress of Accountants. He had the signal distinction also of being asked to express, at the closing session, the thanks of all the delegates to those responsible for making the congress a success. In October, he attended the American Institute of Certified Public Accountants' annual meeting in New Orleans and, in November, travelled by air to Chile, where he represented the Canadian Institute at the 4th Inter-American Conference on Accounting held in Santiago. The same month he visited Halifax and addressed a regional meeting of the Atlantic Provincial Institutes. In January, he paid a visit to the Western Provinces, where he addressed meetings in Vancouver, Edmonton, Calgary, Regina, Saskatoon and Winnipeg. The trips outside Canada helped to strengthen the profession's relations with other accounting bodies in different parts of the world; the remainder af-

forded occasions for discussing matters of interest with the members and gave opportunities to assess better their problems in different parts of Canada.

The Institute's publications during the year have attracted favourable attention, both among our members and businessmen at large. Foremost, perhaps, among these was the second edition of "Financial Reporting in Canada", an analysis and commentary on the reporting trends, since 1953, of 300 Canadian companies. Two important research bulletins issued in August 1957 and April 1958, respectively, were "Standards of Disclosure in Financial Statements" and "Confirmation of Receivables". The Institute also published four brochures "Municipal Finance in Canada", "Integrated and Electronic Data Processing in Canada", "Grain Accounting" and "Accounting for the Forest Product Industries".

In cooperation with the Canadian Bar Association, the Institute, through its Committee on Taxation, again submitted a joint brief to the Federal Government recommending 45 changes to the Income Tax Act. This year the membership at large was invited to forward suggestions to the committee, and a number of useful ones were received.

In reviewing important events of the year, it is fitting to recognize the anniversaries of two Provincial Institutes. The Institute of Chartered Accountants of Ontario, with a membership of close to 3,200, celebrated its 75th anniversary in February. In June, the Institute of Chartered Accountants of Saskatchewan marked the 50th anniversary of its incorporation. The position which the accountancy profession occupies is an enviable one. It is still concerned principally with business management, investors, certain departments of government and allied professions, but there is increasing general public awareness of the chartered accountant's important contribution to the success of Canadian business and the prosperity of the economy as a whole.

During his term as president, Mr. de Lalanne has frequently stressed the challenge faced by the profession in equipping itself to meet the increasing complexities of business and extending its services beyond the more familiar territories. Several illustrations of what he has in mind come readily to the fore. Last year J. Waldo Monteith, F.C.A. was appointed Canada's Minister of Health & Welfare while, more recently, an Institute member headed a Canadian delegation to the 19th International Red Cross Conference which was held in India. There have been a growing number of appointments to top positions in industry while members in practice have increased their efforts to further the planning and conduct of modern business.

As Canada grows, so does the scope of the profession inspiring its members to play an ever more important part in national and international affairs.

The Securities Market in the Canadian Economy

WILLIAM ROBSON

THE GROWTH of the securities market in Canada has been one of gradual evolution, assisted to a degree by the investment experience gained by the Canadian public in buying victory loan bonds in two world wars. Prior to 1900, there was no domestic securities market in Canada. In 1889, for instance, a typical day's trading on the Toronto Stock Exchange involved the shares of seven bank stocks, six miscellaneous and twelve loan company stocks, and total sales for the year aggregated only 176,000 shares. On several occasions in recent years, over 12 million shares have traded in one day on the Toronto Stock Exchange, and the volume of shares traded during each of the past five years has averaged well over one billion shares per year.

In the earlier years of this century, virtually all of the funds needed to finance our expansion and development flowed in from the United Kingdom. While no figure is available of the total amount of invested capital in Canada at the beginning of the century, informed estimates set it at approximately $1,200,000,000 made up chiefly of government, municipal, railway and public utility bonds and the shares of a limited number of companies such as the Canadian Pacific Railway and some banking institutions. Contrasted to this, in the year 1957 alone over $1,400,000,000 of new corporate bond, debenture and stock issues were floated by Canadian business firms.

From 1900 to 1913, to keep up to the very rapid development going on in Canada at that time, foreign capital poured in to a total amount of approximately $2½ billion, more than half of it from the United Kingdom. Although there were in Canada a number of investment houses, their activities, at that time, were mainly concerned with trading in the listed securities of a relatively few companies, principally loan companies and utilities such as the Consumers Gas Company of Toronto. The function of the investment houses in Canada did not extend to the seeking of new capital. The underwriting of securities for government and corporate purposes on any large scale by Canadian investment firms remained, for the most part, in the future.

The outbreak of war in 1914 automatically cut Canada off from the British market and thus provided the opportunity for New York to become

the dominating influence in financing this country's development and expansion. This situation continues until the present day.

By 1916, 65% of all Canadian new issues were being placed in the United States, and only the entry of the Americans into World War I in 1917 eventually forced Canadians to finance their own war effort. It also had the effect of stimulating the development of the Canadian bond market. Prior to this time, those securities which were not being sold abroad were being purchased almost wholly by financial institutions and wealthy individuals. The victory loans, to some degree, familiarized the "average" Canadian with the securities market and provided a basis for expansion of this market which has continued virtually uninterrupted since that time with the exception of the period from 1932 to 1934.

From 1934 until the outbreak of World War II, there was a continual flow of new bond and share financing in Canada, much of which was of a reorganization and refinancing nature. As would be expected, the war years of 1939-1945 witnessed the sharpest increase in the amount of federal government financing in the history of Canada, over $12,200,000,000 being raised through victory and war loans.

After ten years of depression and six years of war, the Canadian economy began a rate of growth that has been the envy of the World. In addition to the rapid expansion which took place in pulp and paper, base metals and manufacturing, completely new industries such as oil and natural gas, electronics, petrochemicals and iron ore, which prior to 1939 had been either in their infancy or yet unknown, substantially added to Canada's rate of growth, as well as to the demand for investment funds in

NEW CANADIAN SECURITY ISSUES

	Bonds, Debentures and Notes				Shares	
	Government of Canada[1] *('000,000)*	*Canadian Provinces*[2] *('000,000)*	*Canadian Munici-palities ('000,000)*	*Canadian Corpora-tions ('000,000)*	*Preferred Shares ('000,000)*	*Common and Class A Shares ('000,000)*
1946	$ 914	$ 133	$ 130	$ 579	$ 80	$ 83
1947	371	275	252	401	91	47
1948	1,425	344	112	305	35	6
1949	821	464	165	294	16	65
1950	2,192	409	182	437	45	99
1951	592	419	224	455	28	166
1952	827	448	241	546	31	128
1953	2,033	391	240	329	85	140
1954	3,400	496	300	594	94	112
1955	1,370	372	298	586	166	190
1956	1,527	635	318	860	190	453
1957	2,602	740	356	1,045	106	356

[1] Direct and guaranteed and other C.N.R., excluding treasury bills, deposit certificates and short-term notes sold directly to the Bank of Canada and the chartered banks. (Source: Bank of Canada.)

[2] Direct and guaranteed. (Source: Bank of Canada.)

the securities market. Within a decade of Leduc, capital expenditures in the oil industry were running at a rate of $1 billion annually. The uranium industry in a period of seven years spent over $300 million, and in so doing raised Canada to the front rank of world uranium producers.

The effect of this rate of growth on the Canadian securities market is reflected in the figures on p. 216.

Supply and Demand of Investment Funds

There are two aspects to the securities market: the supply of funds available to the market and the demand for these funds. The "securities market" implies the function of channelling the available savings into the hands of those who can most effectively use these funds, and any securities market worthy of the name provides many different channels to ensure that both lenders and borrowers may have the highest possible freedom of choice.

Sources of Funds

Apart from private investors, there are four chief sources of funds available to the securities market:

(1) *The accumulation of bank deposits.* These are used to some extent in making funds available for long-term investment, but to a greater degree to assist industry by providing working capital financing inventory and of sales on credit. The personal savings of Canadians on deposit with the Canadian chartered banks in March of this year totalled more than $6.5 billion. Generally speaking, savings deposits increase year by year, and with such huge resources available for the purchase of long-term fixed income securities, loans to industry and residential mortgages, it is difficult to overemphasize the importance of these deposits to the securities market.

(2) *Insurance reserves of life insurance companies.* The following table, taken from the *Bank of Canada Statistical Summary,* March 1958, highlights the importance of these reserves to the securities market, and indicates the type of long-term investments into which these funds are channelled.

The business done in Canada in 1956 by the 12 companies included in the table below was 77.6% of the total of all companies registered under the federal Insurance Acts. It is obvious from the breakdown of

CANADIAN ASSETS OF TWELVE LIFE INSURANCE COMPANIES
(millions of dollars)

As at December 31st	1953	1954	1955	1956	1957
Government of Canada bonds	783	681	641	484	428
Provincial bonds	254	267	253	263	269
Municipal bonds	234	251	273	297	308
Corporate bonds	1,121	1,206	1,229	1,359	1,426
Preferred and common stocks	61	57	61	65	70
Mortgage loans and sale agreements	1,155	1,375	1,665	1,974	2,182
Real estate	103	128	147	174	215
Policy loans	185	197	206	222	241
Cash	28	20	21	29	34
All other Canadian assets	3	2	3	4	4

investments that by far the largest part of insurance company funds enters the fixed "income" area of the securities market, and that until the present time only a very small part of their funds has been invested in "risk capital" or equity securities. However, the desire of many Canadians to participate in Canada's growth, and to hedge against the longer-term forces of inflation, will likely see the common stock holdings of insurance companies increase to the extent authorized by their statutes.

(3) *Pension funds.* A recent study indicates that currently there is approximately $2 billion of investable pension funds in the hands of trust companies, banks, industrial and financial companies, which is growing at an annual rate of between 10% to 15%. In addition, the pension funds of teachers, police and other governmental employees, excluding the federal civil service, amounts to some $350 million. Although pension funds have been in existence for some years, their growth particularly since World War II has been of dramatic proportions, and their increasing supply of funds available to both fixed income and equity areas of the market has had the effect of both broadening and stabilizing the Canadian securities market.

(4) *Investment trusts.* The funds of the portfolio investment companies, both American and Canadian, are among the more recent new-comers to those contributing to the flow of funds available to the Canadian securities market. An indication of the size of the funds available from this source is evident from the fact that since 1954, eight United States portfolio companies have put more than $300 million to work in the Canadian economy, and at the present time their investment in this country, for the most part in equities, is running at a net annual rate of about $70 million per year.

Since the beginning of this century the securities market in Canada has shown remarkable growth, but in growing it has also changed, noticeably during the past decade. The tremendous expansion in contractual savings, in the form of life insurance, annuities and pension funds, particularly during the past decade has naturally increased the powers of institutional type investors over the securities market.

Demand for Capital

The funds available to the securities market are channelled into three main areas: (1) "social capital", that is capital required by the various levels of government to finance such things as highways, schools and hospitals; (2) "personal" capital, funds needed to finance the construction of homes, household goods, etc. (3) capital to finance the expansion of existing business and industry and our natural resource development.

Although the demand for capital during the past decade has been high in all three areas, it has been virtually insatiable in the third. In fact, the need for funds to pay for our unequalled rate of expansion of resources has resulted in the Canadian securities market relying fairly heavily on foreign sources of capital. It is not the intention here to discuss the pros and cons of this situation. It is clear, however, that without foreign capital, Canada could not have maintained her spectacular rate of growth during the post-war period.

It perhaps could be further men-

tioned that the influx of foreign capital in the early years of a country's development, as exemplified in the history of the United States, is a normal evolution. The next stage of the evolutionary process is reached when the country begins to pay off foreign debt and repatriate foreign-held investments. Canada has now reached the stage of paying back foreign holders of Canadian government securities. In time the stage of paying off foreign holders of Canadian equities will undoubtedly be reached.

Short-term Money Market

It was not until 1953 that the Canadian securities market was rounded out to include a short-term securities and money market. Prior to that time, the short-term securities market in this country consisted of a relatively few issues of Government of Canada bonds maturing within three years and Government of Canada treasury bills. Only a minor part of these was held outside the banking system.

In general, five groups are interested in a market in government short-term securities. The federal government finds an advantage in placing part of the national debt in short maturities and thus can minimize the burden of interest payments. From the point of view of the chartered banks, treasury bills are the most liquid items in their balance sheet. They enable the banks to maintain a reserve against an unexpected demand for cash and at the same time earn a modest rate of interest. The broadening of the bill market has also been of material assistance to the Bank of Canada in maintaining orderly securities markets and influencing the supply of money and credit. Corporations and other groups benefit in the same manner as the chartered banks, that is in the employment of temporarily idle cash in safe and liquid assets. The fifth interested group is the investment dealers who carry inventories in, and buy and sell, treasury bills and short-term bonds, in order to make a profit.

Through various measures, the Bank of Canada, in cooperation with the chartered banks and a number of Canadian investment dealers, broadened the money market to a degree that the facilities now enable corporations, provincial governments and municipalities to use idle funds profitably, either on a day-to-day basis or for fixed periods of time, knowing that these funds may be called for other use at any time.

The Canadian securities market has so developed as to make more efficient use of the savings of Canadians so that they may more effectively meet the various demands for capital funds. The investment dealers of Canada have played an equally important part, particularly by educating the Canadian public, through university extension courses, correspondence courses and other media, as to the scope and opportunities of a planned investment program.

Thus far Canada and her securities markets have grown in response to the demands of the rest of the world for Canadian raw materials. This has been a tremendous growth already, but in the opinion of many, we are on the threshold of an even greater, and sounder development, based more on a balanced strength and equilibrium resulting from increased domestic growth.

Trust Administration and Control

A. ERNEST STEAD

A GOODLY PORTION of each person's life is concerned with gaining some worthwhile assets and trying to conserve them in the face of the temptations of normal living and the stimulus to spend created by advertising. If he succeeds in this, then he normally plans the disposition of his estate to carry out some particular desire, usually to protect his loved ones. Volumes have been published on how to acquire money and how to spend it. This article has been written as a quick, non-technical peek behind the scenes of what is involved in a well-run and well-controlled trust administration.

Role of the Executor

As soon as he learns of the testator's death, the first and obviously the most important duty of the executor is to examine the will and take control of the estate. He notes the main points of the will and any special duties in connection with them. All papers and records of the deceased are examined and any safety deposit box is listed in the presence of an official from the Succession Duty Department. Jewellery, securities and valuable papers are taken into safe custody. Banks, brokers and life insurance companies are notified of the death. In short, the executor has to familiarize himself completely with the affairs of the deceased, make a complete inventory of the assets, and perform any essential duties which are pressing for attention.

It is so important not to overlook the personal aspect in these first days of stress. The recently bereaved family will be passing through a highly emotional strain, and an understanding executor can do much to relieve worries and tensions at this time. There must be a preliminary discussion with the widow in order to learn her obligations, whether she has immediate need of funds, and what her income in the future should be.

Probating of Wills

Although the executor's powers and duties arise immediately from the will, it is first necessary to "prove" the will in court and obtain letters of proof or, more commonly, "letters probate". These are, in effect, the charter of authority of the executor and evidence that the Surrogate Court has examined the will and confirmed his appointment. In order to obtain these letters the executor must file a complete inventory with the court. The values shown in the inventory will form the basis of the succession duty calculation and must be arrived at with great care. Listed bonds and stocks are valued according to the market at the date of death.

Shares of a closely-held family company are another matter, as any practising accountant knows, and their valuation can only be determined af-

ter exhaustive study of the financial affairs of the company and consideration of all other factors which have a bearing on the operations. The valuation generally boils down to an estimate based on past, present and future earnings. Real estate and special assets such as expensive furnishings must generally be valued by experts in those fields. A competent executor will complete this inventory and apply for his letters probate as quickly as possible, so that he is empowered to proceed with the whole administration of the estate.

In addition to the application for probate an executor must file succession duty returns promptly. Generally, a succession duty "release" must be received before an asset can be disposed of. A release is obtained after the returns have been filed and the duty either paid or security deposited in lieu of payment. Sometimes there is quite a period before the final settlement of the duty, but meanwhile the executor must proceed with his administration and deal with assets as they are released.

The funds of the estate under administration must be kept absolutely separate and distinct from the executor's own funds and all other trust funds. That is not to say that there cannot be a common bank account for all trust funds, but cash and securities of each individual estate or trust must be individually recorded. That is a cardinal principle and law of trust work. In larger organizations, such as trust companies, the physical custody of the securities is very highly protected by dual control, dual authority and internal check and audit.

Barring special provisions in the will, an executor's usual duty is to realize assets as quickly as possible, pay off debts and make distribution to beneficiaries. There is usually a clause in the will which provides for payment of funeral and testamentary expenses as soon as practicable. Creditors are notified by advertisements inserted in the newspapers and stating that all claims must be entered within a certain period. Stocks are generally transmitted into the name of the executor to facilitate delivery upon eventual sale. This is accomplished by submitting the existing certificates to the transfer agent together with succession duty consents, a notarial copy of the letters probate and a declaration of transmission. This latter document sets out the facts concerning the death, the name of the executor to whom letters probate were granted, the details of the certificates and their physical location, and finally the requirements of the transmission.

Administration of Investments

One of the most important problems that arises in estate administration is that of investments. The deceased's will and the Trustee Act (in Ontario) govern the course of the investing policy. The directions of the will govern first of all, and then the law enters the picture if the will is silent or non-specific. A will may occasionally direct that certain investments be retained, and in that case the executor must retain them pending final distribution. On other occasions, the will may state that the testator's investments may be retained at the discretion of the trustee; perhaps to provide a more orderly realization process. An executor must always exercise his judgment and care in administering the affairs of the estate to the same extent that a pru-

dent man would exercise his own judgment and care in administering his own personal affairs. This is an underlying philosophy of executorship known as the "prudent man rule".

If the executor is required to make investments and there are no wider investment powers in the will, then he is governed by the Trustee Act (in Ontario). This Act authorizes the following investments (briefly):

1. Securities of, or guaranteed by, the Government of Canada, any province of Canada, or the Government of the United Kingdom.
2. Securities of, or guaranteed by, any municipal corporation in Canada including debentures for public, separate, high or vocational school purposes.
3. Debentures secured by or payable out of rates or taxes levied under any provincial law and collected by a municipality in the same manner as general municipal taxes.
4 First mortgages on real estate, up to 60% of the valuation made by a competent valuator.
5. Bonds or debentures issued by a corporation which receives subsidy payments from the Government of Canada sufficient to pay the principal and interest on the bonds or debentures.
6. Guaranteed investment certificates of trust companies registered and approved under the Loan and Trust Corporations Act.
7. Debentures of loan corporations subject to certain restrictions.

It will be seen from the above list that investment power under the statute is fairly narrow, and many wills authorize broader investment powers such as investing in securities which are legal for life insurance companies. This brings in corporate securities and stocks of companies which have shown a stability of earning power for a number of years past. However, the "prudent man rule" still applies and investments must be made with prudence having regard to the circumstances, whether or not they are legal trustee investments.

Control of Estate Accounting

The work of the executor ranges far more widely than dealing with investment problems. It is possible for every conceivable type of asset to be found in an estate, and a competent, experienced executor will acquire a deep knowledge of all subjects. For instance, an estate may have to carry on a business which was owned by a testator, or the executor may have to administer a farm or perhaps liquidate a stable of horses. The accounting involved in an estate differs quite a bit from normal commercial accounting.

There is often a divergence of interest between the beneficiaries who are entitled to the income from the estate, who are known as "life tenants", and the beneficiaries who are entitled to the capital or residue of the estate, who are known as "remaindermen". Thus, it is most important that receipts and disbursements be allocated properly between revenue and capital. This strict allocation has to be preserved all through the accounts. Generally each estate has a control account for all of the assets under administration and at all times the balances of the individual securities' accounts must agree with this control figure. The collection of revenue is most important, and in trust companies the interest and dividends which are coming due

on the individual securities are all predetermined, so that no revenue will be lost. Similarly, rents and mortgage payments are diarized on their due dates.

Another control on the administration of the estate is exercised by the act of passing accounts in the Surrogate Court. This is generally done on a minimum of once every three years. The passing can be dispensed with if all the beneficiaries are of major age and all agree to the accounts of the executor. A Surrogate Court judge has wide powers under the Surrogate Court Act. Section 72 provides that:

> The judge, on passing the accounts of of an executor, administrator or such a trustee, shall have jurisdiction to enter into and make full inquiry and accounting of and concerning the whole property which the deceased was possessed of or entitled to, and the administration and disbursement thereof in as full and ample a manner as may be done in the Master's office under an administration order, and, for such purpose, may take evidence and decide all disputed matters arising in such accounting subject to appeal.
>
> The judge, on passing any accounts under this section, shall have power to inquire into any complaint or claim by any person interested in the taking of the accounts, or of misconduct, neglect, or default on the part of the executor, administrator or trustee, occasioning financial loss to the estate or trust fund, and the judge, on proof of such claim, may order the executor, administrator or trustee, to pay such sum by way of damages or otherwise, as he may deem proper and just, to the estate or trust fund; provided that any order made under this subsection shall be subject to appeal.

It can be readily seen that great protection is afforded to beneficiaries under the Surrogate Court Act, and that it affords wide control on the executor. It may be noted in passing that the executor's fee is also determined by the Surrogate Court judge at the time of passing and is contained in a "memorandum of compensation". It is rather odd that there is no fixed tariff for the performance of executor's duties, but only what is allowed to be reasonable by the court. This must be one of the few areas of work today where one's fees are not accurately determined in advance.

Trustees and Their Duties

So far, trust administration has been discussed only in relation to estates. There can be trusts set up while the grantor is still alive and referred to as "living trusts", and there can be trusts set upon death and known as "testamentary trusts". These are generally created to deal with a specific problem such as providing income for the maintenance and welfare of a certain individual.

Many of the duties and responsibilities of the trustee are similar to those of the executor. He must be bound by the trust document as the executor is by the will. He must manage the affairs of the trust with prudence and take all precaution to administer the trust in the interest of the beneficiaries. If there are no specific provisions otherwise, the trustee is still bound by the provisions of the Trustee Act as regards investments. He must keep the affairs of the trust distinct and separate from those of other estates and trusts and also, of course, from his own property. It is difficult to generalize about trusts. Each one is an individual case and must be handled according to its own purpose and the trust document.

In recent years, pension trusts have become a very important part of our

financial economy and trust companies are generally appointed trustees under pension plans. This involves a setting up of a specific trust where an employer and his employees can deposit money into an investment pool to build up a pension for each employee when he reaches his retirement age. There is no need to explain this in detail, as pension funds are fast becoming universally popular, and it is readily accepted that both employer and employee must make some contribution towards the date of retirement. The trustee in this case holds the money in trust for the employees, administers the fund, generally recommends upon the investments and pays out pensions as required. These trusts are mostly distinguished by the fact that they involve many dollars, many people and a multiplicity of duties. However, the same basic ideas of control and the same basic philosophy of the trustee relationship must be present. In addition these funds must be approved for income tax purposes, with the resultant scrutiny of the underlying document by government officials.

Bond Trusteeship

Another great area of trusteeship, particularly for trust companies, is that of the bond trusteeship. This arises when a corporation wishes to raise borrowed capital in the public market. It does this by issuing bonds. As well as the promise to pay, the underlying security of the bonds issued is the mortgaging of the corporation's assets to guarantee repayment. It is manifestly impossible for a corporation to issue separate mortgage agreements to each purchaser of its bonds. The answer is to create a bond trusteeship whereby a trustee holds a mortgage on the property of the borrowing corporation as security in trust for all of the bond holders. There is a trust deed executed wherein are set out the terms of the mortgage, the covenants of the borrowing corporation and all of the powers, duties and obligations of the trustee. The trustee authenticates each bond certificate issued as proof that it is one of the bonds issued under the trust deed. The terms of the mortgage usually provide for a specific charge upon the real estate of the corporation described in such a way that it may be registered. Often there is a clause which adds on property acquired afterwards. Current assets such as inventories are generally left free so that the corporation may borrow on them under section 88 of the Bank Act.

As well as a specific charge on real estate, the trust deed will also contain what is known as a "floating charge". This actually sweeps into the net of the trust deed all of the assets of the corporation including cash, receivables, inventories, goodwill and intangible assets. Its effect is to leave the company free to deal with its assets in its usual manner unless default, winding-up or bankruptcy occurs, but then the clause operates to bring in all the assets as security for the bonds.

The company also has to make certain covenants. For instance, to pay off the principal and interest of the bonds, to maintain proper insurance, to exercise proper care and management in dealing with the company's assets, and not to pay dividends which will reduce the liquid assets of the company below a certain minimum. There are usually a number of negative covenants.

The duties of the trustee are many

and varied. His primary one, of course, is to take action to protect the rights of the bond holders. If there is a default in payment, after a certain period of grace the action generally involves the appointment of a receiver and perhaps foreclosure and sale of the assets. The trustee's general duties, aside from default, include such matters as seeing that proper insurance is kept, releasing property from the trust deed if permitted, and seeing that new property goes under the trust deed. However, it is not the trustee's duty to interfere with the proper management of the business, but only to examine those matters which have bearing on the trust deed and bond issue.

Much of the work involved in bond trusteeship is in the handling of the bond certificates, in their registration, transfer and redemption. The trustee must maintain complete records showing all the particulars of the issuing of the bonds, their serial numbers and the names and addresses, if registered. Very frequently, the permanent bonds, or so-called "definitives", have not been engraved and delivered when the trust agreement is signed. Therefore, so-called "interims" are issued in the first instance. These are not so elaborately designed and do not have coupons. In the due course of time, interims are brought in and exchanged for definitives. This complicates the work of the the trustee, as he must account for and authenticate both types of bonds. Bonds are issued in various denominations; upon transfer, bonds of one denomination are frequently exchanged for bonds of different denominations. Insofar as the control aspect of bond trusteeship is concerned, dual custody is usually exercised over unissued certificates. Exchanged certificates are cancelled promptly and marked off to the original entries. Periodically, old cancelled certificates are cremated under dual authority so that no temptation for misuse will arise.

Legal Protection of Trust Funds

Occasionally one reads in the newspaper of a case where a trustee has misused trust funds. This particular type of malfeasance comes with a shock to the public at large, and there is generally comment made to the effect that the laws should not permit such happenings. The law does not permit indiscriminate use of trust funds, but the policing of the law is difficult. Most persons who deal with the public have to make some declaration with regard to their disposition of trust funds. For instance, when a real estate broker applies to the Department of Insurance for renewal of his registration he has to declare that all trust funds pertaining to real estate transactions owing to his clients are held in a trust account, entirely separate from his general account, with a record in a trust ledger.

Trust companies, which are the chief corporate bodies specializing in trustee work, are subject to wide government supervision and must make detailed returns to the various departments of insurance. Their affairs are examined by insurance auditors as well as their own shareholders' auditors.

The duties of a trustee are exacting, detailed and highly responsible. No one should lightly undertake trustee's duties without being aware of the intricate provisions of the law regarding their performance.

The Taxation of Partnership Income

JOHN G. McDONALD

ALTHOUGH THE partnership form of doing business is numerically more popular than the corporate form in our business community, the Income Tax Act is comparatively silent on the subject of partnerships.

A great variety of intricate corporate transactions is anticipated and dealt with by specific tax rules, but partnership arrangements are a neglected second cousin.

One of the results of this is that the Department of National Revenue is developing administrative practices to meet partnership situations that are ignored by the statute.

The Basic Charge

Section 6(c) of the Act provides that "there shall be included in computing the income of a taxpayer for a taxation year the taxpayer's income from a partnership or syndicate for the year whether or not he has withdrawn it during the year".

A partnership is not a legal entity; it is the "*relation* which subsists between persons carrying on business in common with a view to profit".

Although a partnership is an "accounting entity" in the sense that the financial record of its business operations must be kept without regard to the financial affairs of its members, it is not a taxpayer.

Each partner is required to report his *share* of firm income for income tax purposes, and adjustment of the partnership relation between partners involves personal rather than firm tax consequences. "It is with partners as individuals that one must deal", *Friesen,* 53 D.T.C. 237; 8 Tax A.B.C. 346.

This "attribution" of firm income to the partners presents special accounting problems.

Partnership Fiscal Period

By virtue of section 15(1) of the Income Tax Act, a partnership fiscal period need not coincide with the calendar year. The year of inclusion of partnership income is the calendar year in which the firm fiscal period ends.

It follows that the member of a firm may have at least two personal fiscal periods, and income received by or attributable to him in the taxation year from all sources will have been earned over a period longer than 12 months if the firm fiscal period does not coincide with the calendar year. For example, a partner employed elsewhere than with his firm,

or an active partner receiving investment income, must report firm income for the 12-month firm fiscal period *ending* in the year plus other income received during the calendar year.

This is merely a timing problem, but it can have serious consequences when a firm is wound up or when the taxpayer ceases to be a partner.

Termination of Partnership

Unless the partnership agreement otherwise provides, the firm dissolves automatically upon the death, bankruptcy or withdrawal of a partner.

Such dissolution also terminates the firm's fiscal period and may create a situation in which the continuing partners in a new firm replacing the old have two partnership fiscal periods ending in one calendar year. For example, a firm with fiscal year ending June 30 may be dissolved on November 30.

The continuing partners may select June 30 for the new firm, thus limiting their combined fiscal periods to 12 months.

But if a new firm is *not* created, they should elect under section 15(2) of the Income Tax Act that the incomplete firm fiscal period shall be deemed to have ended at June 30. But for this provision they would be obliged to pay tax on income received over the 18 month period ending on December 31.

A similar relief provision is provided by section 37(2) of the Act for a partner who withdraws from the firm and obtains employment income during the balance of the calendar year.

Upon the death of a partner, section 44(4) also permits an election to be made by the personal representatives to file a separate return for a split fiscal period.

Partnership agreements commonly provide that the firm shall not terminate upon the withdrawal of a partner or the admission of a new partner. The firm fiscal period in such cases remains undisturbed.

Allocation of Deductible Expenses

Where a partnership carries on from year to year with no change in its membership, firm income is simply allocated to the partners in the agreed proportions, and each partner attaches to his income tax return a copy of the firm financial statement showing the method by which income was determined.

This procedure must be modified in the case of new partners who have purchased interests in the firm at enhanced prices.

Depreciable Property

For example, take the case of equal partners *A* and *B* who subscribe $50,000 each to their firm. The firm invests $50,000 in a building, $10,000 in land, and $40,000 in stock in trade. At the end of the first fiscal year the undepreciated capital cost of the building in the firm accounts is $47,500 and inventory remains unchanged in amount. The firm determines its income by the accrual method.

Next, assume that *A*, with *B's* consent, sells his one-half interest in the partnership to *C* for $65,000 with an allocation of the consideration as follows:

	(½ interest)
Goodwill	$10,000
Building	30,000
Land	5,000
Inventory	20,000
	$65,000

Under section 20(1) of the Act, *A*

must include $1,250 in his income for the year of sale. The balance of his "capital gain" of $16,250 is not taxable, *No. 408*, 57 D.T.C. 124; 16 Tax A.B.C. 417, *No. 315*, 56 D.T.C. 82; 14 Tax A.B.C. 311, *No. 379*, 57 D.T.C. 34; 16 Tax A.B.C. 288.

C, on the other hand, has paid $30,000 for an undivided one-half interest in a building that stands in the partnership books at $47,500. His share of this undepreciated capital cost is $23,750.

At the end of the second year of the business *C's* income will therefore be overstated unless a portion of his additional capital cost is taken into account. *C* is therefore entitled to deduct 5% (Class 3, Schedule B, Income Tax Regulations) of $6,250, or $312.50 *in addition to* the capital cost allowance already deducted in the firm accounts. The reason for this is that the firm's assets "are owned by the partners as individuals and not by the partnership as though it were a *persona*", *No. 117*, 53 D.T.C. 345; 9 Tax A.B.C. 100.

Inventory

The same rule applies to inventory, subject to section 85E of the Act, and although the application of that section to partnership interest sales is not yet common, the practice of at least one District Taxation Office is to adjust cost of sales in determining the income of a new partner who has acquired his share of inventory at a figure other than that shown in the firm accounts.

As the law now stands, the Department could also apply section 85E(1) in dealing with the vendor of a partnership interest, in the absence of agreement between vendor and purchaser under section 85E(2). We are presently unaware of any assessments in which "deemed" inventory profits have been taxed to a vendor under the section.

Accounts Receivable

Here again, the retiring partner falls within the statutory provisions and case law governing sales of business property.

In the absence of an election under section 85D, the *Borenstein* rule (54 D.T.C. 263; 10 Tax A.B.C. 394) applies and accounts receivable reduced by a reserve for doubtful debts in the firm accounts may be dealt with by the new partner at his share of their *net* book value without the necessity of including in his income his "share" of doubtful debts under section 6(e).

Assume that in our example no amount is allocated to goodwill but $10,000 is allocated to book debts carried in the firm accounts at $24,000 less a reserve of $4,000 for doubtful debts.

In the absence of an election under 85D, *A* suffers at $2,000 inclusion under section 6(e) in the next year and *C's* share of any subsequent recovery of doubtful debts beyond the $10,000 paid for his interest is a capital receipt for the purpose of computing his income, *I.R.C.* v. *Reynolds & Gibson,* [1952] 1 All E.R. 888; 33 T.C. 288.

If the firm reported income by the cash method, there would, of course, be no reserve for doubtful debts, and $12,000 would be included in computing *A's* income for the year of sale under section 85F(4). *C*, on the other hand, should not be taxed on subsequent recoveries of accounts receivable. (But see *No. 329*, 56 D.T.C. 17; 14 Tax A.B.C. 444).

The foregoing applications of the law are not always followed in practice in view of the conflicting theories of partnership at law and in equity. In the common understanding, a partnership firm is a distinct business entity similar to a corporation. Under the Partnership Act "property bought with money *belonging* to the firm is deemed to have been bought on account of the firm". From the accounting standpoint, at least, the firm is an entity, not a shadowy "relation" between the partners.

Notwithstanding this, the law regards a partnership as a "jural aggregate" and "looks to the partners composing it; any change among them destroys the identity of the firm; what is called the property of the firm is their property, and what are called the debts and liabilities of the firm are their debts and liabilities".

It follows that upon the sale of a partnership interest the provisions of the Income Tax Act governing sales of business assets must be applied. No separate ownership of those assets is vested in the firm, but remains with the partners.

Sale of Partnership Interests

Although a partnership is nothing more than a contractual relation under which partners acquire rights and privileges and are subjected to vicarious financial responsibility, a partner's contractual right as partner is *itself* property within the meaning of section 139(1)(ag) of the Income Tax Act.

The proceeds of sale of that contractual right, the partnership interest, are capital except to the extent that specific provisions of the Act decree otherwise.

The logical corollary of this rule is that an amount paid to acquire a partnership interest is a capital outlay the deduction of which in computing income is prohibited by section 12(1)(b) of the Act, *Royal Trust Co. et al.*, [1948] Ex. C.R. 213; 3 A.T.C. 1123; [1948] C.T.C. 21.

These rules must be borne in mind when a partner is "bought out" by his partners. The most common situation in this category arises when partners agree to continue to share profits in some form with the widow of a deceased partner.

Case *No. 41*, [1952] Ex. C.R. 416; 52 D.T.C. 1150 shows that there are two ways of doing this; under one the payments by the surviving partners are deductible and under the other they are not.

If the surviving partners wish to deduct payments made to acquire a deceased partner's interest in the firm they must *not* buy that interest as such. They must take the widow or other survivor into the firm as a partner, and this may be done for a limited period to produce the same economic result that would have been otherwise achieved through an outright purchase.

Husband and Wife Partnerships

Section 21(4) of the Income Tax Act provides that:

> Where a husband and wife were partners in a business, the income of one spouse from the business for a taxation year may, in the discretion of the Minister, be deemed to belong to the other spouse.

The discretion of the Minister under this section is absolute, and will not be interfered with by the courts even if the husband and wife each contributed a share of the firm capital and a *bona fide* partnership exists,

Klamzuski, 52 D.T.C. 51; 5 Tax A.B.C. 357; *Goodman,* 51 D.T.C. 50; 3 Tax A.B.C. 280.

Parent and Child Partnerships

In the common law provinces the absence of a contribution of capital or labour to a partnership business does not negative the existence of the partnership relation. In Quebec, although some contribution must be shown, it need not be substantial, *No. 71,* 52 D.T.C. 361; 7 Tax A.B.C. 165.

Family income may effectively be split between father and son in a partnership in which the bulk of the firm capital is contributed by the father, *Parton,* 55 D.T.C. 81; 12 Tax A.B.C. 155. Further, in the absence of donative intent, gift tax is not exigible.

In the *Parton* case the father-son capital contribution ratio was $6:1 and the partnership agreement provided for an equal division of profits.

Estates as Partners

The same considerations apply to estates and trusts. A husband who is prevented from splitting partnership income with his wife during his lifetime may do so after his death through the medium of a trust. One-half of his firm income may be left in trust to his children and one-half to his wife for life. The trustee and the widow share the income and the tax under the terms of the deceased partner's will.

Such arrangements are, of course, subject to the practical necessity of securing the concurrence of the surviving active members of the partnership and subject to the legality of the arrangements under the relevant statutes governing partnerships.

The Purpose of Education

At school you are not engaged so much in acquiring knowledge as in making mental efforts under criticism. A certain amount of knowledge you can indeed with average faculties acquire so as to retain, nor need you regret the hours you spend on much that is forgotten, for the shadow of lost knowledge at least protects you from many illusions. But you go to school not so much for knowledge as for arts and habits; for the habit of attention, for the art of expression, for the art of assuming at a moment's notice a new intellectual position, for the art of entering quickly into another person's thoughts, for the habit of submitting to censure and refutation, for the art of indicating assent or dissent in graduated terms, for the habit of regarding minute points of accuracy, for the art of working out what is possible in a given time, for taste, for discrimination, for mental courage and mental soberness.

— William J. Cory, 19th Century master at Eton College.

Criteria for Evaluating Punched Card Applications

FRANCIS H. FRITZ

For many years businessmen interested in the application of punched card equipment have been seeking some convenient rule of thumb which could be used to determine whether punched card methods could satisfactorily be applied to their data processing requirements. There is no simple answer to the question "Should I use punched card machines in my business?" But there are certain criteria which can help in arriving at a decision.

Although punched card methods have been successfully used in almost every phase of accounting and statistical data processing, a satisfactory application by one company does not necessarily indicate that this can be accepted as a criterion, even in the same type of business. Variations in volume, degree of centralization of the organization, management policies, and many other factors can make or break an apparently sound application.

The punched card is a convenient medium for storing data in such form that it can be read and manipulated by automatic machine processes. Because of this, it is widely used for input, storage, and output of electronic computer systems. The evaluation of electronic applications is not within the scope of this article, and the criteria which will be discussed are confined to those which have been found to be effective in evaluating the application of the more common types of punched card equipment, such as machines for punching, sorting, calculating and document printing.

Procedure Analysis

Any study to determine the applicability of punched card methods must start with a critical and detailed review of existing data processing procedures. In most cases, such procedures undoubtedly were, at some time, carefully planned and presumably efficiently operated. Changing requirements, however, may have prompted modifications to some routines which may have not been properly integrated and which may have affected the efficiency of a system that is otherwise basically sound. Therefore, at the outset a careful review of the existing procedures is necessary to ensure that the best use is being made of the tools already available. This will guard against punched card methods being credited with improvements which could have been made independently, and at the same time a knowledge is gained of

the volume, constraints, and costs which must be considered in evaluating the economics of a mechanized system.

Multiple Use of Basic Data

The first test of feasibility generally is "How many practical uses can be made of the basic data?" In any system of integrated data processing, one fundamental principle is that data must be recorded in such a form that it may be mechanically perpetuated and manipulated. The efficiency of the system increases in proportion to the number of uses to which the basic data can be put. At least three distinct uses are the generally accepted minimum requirement for an efficient punched card application. For example, in a sales analysis application, summaries of sales by product, by salesmen and product, and by type of customer and product, would represent three different uses of the same basic data.

Distribution of Data

The second test is "How many times does the data need to be sorted or otherwise manipulated to produce the desired end-result?" This might be either a report or an arrangement of the punched cards into proper sequence for filing or reference. One of the most important features of punched card equipment is the ease with which the cards may be sorted into any desired sequence. In general, therefore, the more sorting required to arrange the data, the more efficient the system becomes in comparison with other methods.

Using sales analysis again as an example of an application under consideration, a product breakdown involving only 20 classifications and ten sales territories would require very little sorting. Consequently there would be limited value in machine processing by punched card methods provided that no further distribution of the same basic data was needed. If, on the other hand, the product breakdown involved several hundred classifications and many sales territories, the features of a punched card system would be much more significant. In the first case, the limited distribution could probably be done far more economically by other methods. In the second case, with a much more detailed distribution, consideration of punched card methods is indicated and especially if other reports from the same basic data may be required.

Arithmetic Processes

Although arithmetic requirements will vary greatly with the type of application under consideration, the third test usually applied is "How many computations are required and can these be performed without going beyond the economic scope of available punched card calculating equipment?". For example, punched cards may be considered for an invoicing procedure as well as for sales analysis. The order form is to be used as a source of original data. The arithmetic computations in this instance required for the extension of the invoices and calculation of discounts, sales taxes, freight adjustments, and so on, may or may not be within the scope of the conventional type of punched card equipment. This test would determine whether the use of punched cards for extensions was practical or otherwise, which might be the determining factor in deciding on the feasibility of the entire application.

Volume

Overriding all of the three tests outlined above is perhaps the most important criterion in evaluating the practicability of any application: the volume of data to be processed, that is, "How many punched cards will have to be put through each machine process?" Volume usually determines the types of processing, and consequently the range of equipment, which can be economically considered.

It may be found, for example, on the basis of the first three criteria outlined above, that punched card methods for invoicing and sales analysis appeared to be basically sound. However, the volume of the data to be processed for these applications may prove to be so small that the cost of installing the types of machines to perform the operations required in these applications is not warranted when compared with alternative methods. But if some of the work, for instance sales analysis, passes all but the volume test, consideration might still be given to having the processing done by a service bureau. Some of the benefits of the punched card methods are thus secured without an uneconomical investment in equipment. Another alternative would be to reserve judgment on the initial application pending investigation of the possibilities of other uses for the equipment, which, if practical, might absorb enough of the machine cost to justify the installation of the equipment for the work initially considered.

The foregoing criteria deal with the applicability of the basic features of punched card methods. Only if the work under review can pass these tests, would further investigation be warranted.

Conversion of Basic Data

The efficiency of a punched card system is wholly dependent on the accuracy of the basic data and on its correct transcription into the punched cards which are to be read by the machines and processed by them as automatically as possible. The following tests must, therefore, be applied:

1. Is the basic record legible and accurate?
2. Is the data in acceptable machine codes, with accounts, products, territories, and so on identified numerically?
3. If not so recorded in acceptable machine codes, is it expressed in a form that can be correctly interpreted and accurately converted into machine language by coding?

No worse decision can be made than to proceed with a punched card system based on source data which is illegible or otherwise ambiguous, or is inaccurate, and, consequently, susceptible to more than one interpretation in the initial recording for machine processing. Examples of such deficiencies are often found in handwritten source records, in indistinct copies of typed documents, and in the absence of standard nomenclature for identifying accounts, products, and so on.

Regardless of the method selected for the transcription of data into punched card form, the cost of this essential operation is largely dependent on the clarity and form of the source record, and frequently is the deciding factor in determining the feasibility of the application.

From the foregoing it is apparent that another very important test of feasibility is "What work is involved in converting input data by punch-

ing the information into the cards and verifying that it has been accurately recorded?" Applications of a purely statistical nature can usually tolerate some degree of error without significant effect on the value of the information produced. On the other hand, such accounting applications as invoicing, accounts receivable and payroll, usually demand absolute accuracy in the recording of the basic data in punched card form. There are numerous methods of doing this work, such as key punching, pulling prepunched cards, using key driven machines directly connected with punching machines or integrated with card punches through punched paper tape. All require some means of verification of the accuracy of the data ultimately punched into the cards. Unless the conversion of data into machine language can be performed accurately, and at a cost commensurate with the value of the overall results to be derived from the punched-card application, the system is unlikely to be practical.

Internal Control

The practicability of punched card methods is also dependent in large measure on the existence of adequate internal control. Procedures must be introduced to ensure that all data fed into the system is accounted for, and is reconciled with basic controls established independent of the source documents, as well as with other controls subsequently developed within the machine processes.

In a simple sales analysis application, the invoice might be the basic source document, and the basic independent control requested by a total of the postings for the invoices to the accounts receivable ledgers. In this case, each sales analysis would be balanced to the accounts receivable control. However, if it is proposed to write the invoice by punched cards from basic data provided on a priced order form, with the extensions being made by automatic machine processes, the basic control would probably be the quantities shipped. A secondary control developed in the course of machine processing would be the invoice totals. The sales analysis reports, subsequently developed, would be reconciled to both controls.

Output Data

In addition to the foregoing tests relating to machine processing, input data, and internal control, consideration must be given to the adequacy of the system to meet the output requirements, as follows:

1. Will the documents and/or reports produced meet the time schedule specified?
2. Will the output data be in acceptable form?
3. Will stored data be sufficiently accessible to meet any reference requirements?

Although punched cards can be processed at higher speeds than are possible in other data processing systems, electronic computers excepted, they will usually produce only one document or report at a time. Techniques using duplicate sets of cards, summary cards, slave output units, and so on tend to modify this limitation, but it is often found that other methods involving less integration can produce the desired end results in shorter elapsed time.

Although it is usually desirable to produce the finished document directly from the punched card equipment, it is also important to test the output requirements to ensure that

uneconomical punched card machine processes are not introduced into the system to meet an output requirement which could be more efficiently met by other methods of reproduction. It would not usually be desirable, for example, to introduce into the system an elaborate and costly document printing machine which would only be used for a very small percentage of the total output, if the essential output data could be produced on a machine of lesser complexity and put into the proper form subsequently by other and more economical methods.

A further test of output efficiency is the facility with which reference requirements can be met. Most data processes produce, at some stage, information which must be referred to on a day-to-day basis. Examples of such reference requirements are accounts receivable balances for the approving of credit, job costs, stock records, and production schedules. The punched card system must meet such reference requirements without time-consuming and cumbersome machine processing.

Qualified Personnel

The successful application of punched card methods is dependent on the availability of qualified personnel to plan and operate the system, and therefore the following tests must be applied:

1. Are they available?
2. Should they be hired?
3. *Will* they be hired?

Because of the rapid expansion of the application of punched card methods and the newness of many of the tools, personnel with great experience are in extremely short supply. Many companies approach the problem by selecting staff from within the organization and having them trained by the equipment supplier. Providing personnel of suitable calibre are available, this has proved to be an acceptable approach, but if they are not available within the company then qualified staff should be engaged from outside. It is often far easier to teach a man who fully understands the principles of punched card methods all that it is necessary for him to know of a particular application than it is to teach a man who has had many years experience in a limited sphere of clerical activity all the details of punched card equipment.

Overall Cost v. Value of Results

Lastly, there must be a comparison made of the cost of the system in relation to the overall value of the results it is expected to produce. The direct cost of the procedure selected on the basis of the other criteria may be higher or lower than the cost of alternative methods, including the existing system. If higher, the system selected should provide features which compensate for the additional expense such as more accurate, timely, or pertinent data which can be applied by management to reduce costs in other areas. But regardless of the features of a given punched card system it must be tailored to fit the capacity of the potential user's ability to pay for it without undue reliance on intangible and contingent savings which may or may not materialize.

Conclusions

Punched card methods have been successfully applied by a host of satisfied users. However, this fact, plus

the speed and other dramatic features of punched card equipment, has many times led the uninitiated to believe that the mere acquisition of such machines will solve their data processing problems. Without adequate analysis of the work to be performed, development and testing of detailed operating procedures prior to installation, parallel of old and new procedures until such time as the latter are operating efficiently, and a proper program of work simplification, the introduction of punched card equipment can easily result in work complication. No worse step can be taken than to enter into an installation program without competent staff, proper supervision and the active support of management.

What Use is History?

Not all of us agree about the benefit to be had from studying the past. People who believe its experiences should be used today and passed along in trust to their successors rub elbows with those who think that tradition and precedent are a ball and chain hindering progress.

What a pity it is that this should be so! The vital beliefs and good practices of our western world rest on the fulcrum of historic knowledge. There is no basis for our society save its past. There is no guide to business decisions except that given by experience. There is no personal maturity that is not built upon reflection on the events of yesterday.

It is time that Canada became actively interested in her history. We cannot be politically mature without an intelligent awareness of our past. Yet, said Dr. Hilda Neatby in a paper prepared for the Royal Commission on National Development in the Arts, Letters and Sciences: "We have as yet no national history, and no genuine consciousness of the past." Even our political biography is sparse, because "Canadian statesmen have succeeded in shrouding themselves in obscurity."

The work so far done by scholars is of a high order, but it is fragmentary and local. Two things are needed: to bring our history together on the scholarly level, so that we shall have our past in a connected story, and to bridge the gap between that scholarly history and the man-in-the-street.

On the broadest plane, what reason is to the individual, history is to the human race. By virtue of reason, man is not, like the brute, limited to the narrow present, but also has available to him the incomparably more extended past with which the present is linked and out of which it has proceeded.

— Abstracted from *The Royal Bank of Canada Monthly Letter*, August 1958.

Tax Status of a Foreign Corporation in Canada

JOHN A. McCLELLAND

In the view of many non-residents, Canada is regarded as a tax haven. In addition, Canada offers good services, fair treatment, freedom from exchange controls, a growing capital market, extensive and rich sources of raw material and close proximity to the United States. Canadian tax policy has evolved with the desire to promote rather than hinder the conducting of international operations on Canadian soil. The Canadian income Tax Act looks most favourably on capital invested in companies conducting mining operations, companies defined as foreign business corporations and non-resident-owned investment corporations. It is the intention of this review to throw some light on these companies and other taxation factors that affect foreign businesses in Canada.

In general, Canada does not offer concessions to non-residents unless they are also available to residents. A Canadian resident subsidiary of a non-resident corporation is subject to the same general corporate taxes as a Canadian-owned company. An attempt will be made to consider some of the advantages and also some of the tax difficulties likely to be met by businesses operating in Canada, the nature and extent of these differing according to the origin of the capital being invested.

Canada has attracted a greater volume of foreign private capital than any other country, the principal sources being the United Kingdom and the United States. Since the last war, direct investment in Canada has greatly exceeded portfolio investment. This has been prompted for the most part by the general desire of U.S. investors to participate in the long-term growth of the Canadian economy as well as in the general development of industrial integration in North America. It is a fundamental fact that the Canadian political and economic environment offers exceptional guarantees of stability and prosperity.

United Kingdom direct investments, which rank second to those of the United States, are chiefly in manufacturing establishments, merchandising and mining, and are more important in the consumer than in the durable goods industries. Other European investors include Belgium in the oil industry, and capital through several sources directed through Swiss banks.

General Tax Considerations

Quebec and Ontario alone of the provinces exercise their rights to levy

income tax, but the subject is highly complex and beyond the scope of this article. It is sufficient to say that there are fundamental differences in the liabilities for tax under the federal and provincial statutes. Furthermore, tax treaties made by Canada with other countries do not include the provinces in their terms.

The withholding tax on income distributed to foreign investors is an important feature of Canadian taxation. In the case of foreign shareholders of Canadian subsidiaries, it represents a tax on the payment of dividends by those companies. It is payable even though the dividends may not be transferred abroad.

Ignoring any special terms in conventions made by Canada and other countries, dividends and interest paid to the non-resident shareholders of a company incorporated in Canada bear the full 15% withholding tax at source, but this rate is reduced to 5% on dividends if the subsidiary is wholly-owned. Variations of the general withholding tax procedure are found, and it is prudent for potential investors to obtain advice on these matters. For example, dividends paid by a non-resident-owned investment corporation to its shareholders are normally free from withholding tax.

Finally, as far as general considerations are concerned, the problem or burden of international multiple taxation should be mentioned. Anglo-American countries, including Canada, resort to the device of the foreign tax credit in their unilateral statutory provisions to relieve the burden, but Canada also applies outright exemption on dividends received by a corporation from either a foreign business corporation or non-resident corporation more than 25% of the issued share capital of which belongs to the receiving corporation. Canada has pursued a policy of making bilateral agreements for the avoidance of double taxation and these exist now with the United Kingdom, the United States, New Zealand, Ireland, South Africa, France, Germany, Denmark, Sweden, the Netherlands and Australia.

Business Organizations

For businesses considering entry into the Canadian field, it is important to determine the form of organization most beneficial taxwise. A number of alternatives are available. A Canadian business could be operated by:

1. An investment company.
2. A non-resident-owned investment corporation.
3. A foreign business corporation.
4. An independent agent or representative.
5. A branch of the parent company.
6. A company incorporated in Canada, but with non-resident management and control.
7. A company incorporated in Canada with local management and control.
8. A company owned through individual foreign shareholders of a foreign company owned by these shareholders.
9. A company partly owned by U.S. or U.K. residents for the purpose of owning investments in their own countries.
10. For U.S. corporations only, the formation of a U.S. subsidiary with the status of Western Hemisphere Trade Corporation.
11. For U.K. companies only, overseas trade corporations.

These types of organizations are

described briefly in the paragraphs that follow.

The Income Tax Act contains provisions that give favourable treatment to corporations providing channels for the investment in Canada by non-residents. They are primarily designed to stimulate the inflow of direct investment capital. These concessions apply both to investment companies and to non-resident-owned investment corporations, as defined in the Canadian Income Tax Act. It is often preferable for foreign investors to resort to the latter type of company due to the stringent limitations on companies of the first type. N.R.O. investment corporations (as they are called) are subject to tax at a flat rate of 15% on their taxable income, and no withholding tax is imposed on dividends. They are essentially investment holding companies for non-resident interests.

Basically, foreign business corporations are companies incorporated in Canada that have all their assets and conduct all their business abroad. However, they may have substantial business offices and accumulated funds in Canada. They are exempt from Canadian corporate tax and are only required to pay a fee of $100 per year. Their shareholders are subject to withholding tax at the normal rates on distributed dividends. Thus, it is possible for such companies to expand or accumulate funds without the incidence of taxation, except that imposed by the country or countries in which they do business.

Two Exceptions

There are two important exceptions to the 15% rate of withholding tax on dividends distributed to non-resident shareholders of foreign business corporations:

(a) In general, where the foreign business corporation is a wholly-owned subsidiary of a non-resident corporation and is principally engaged in making loans, the rate is reduced to 5%.

(b) Normally, if 90% or more of the profits were derived from the operation of public utilities in the country of residence of the non-resident shareholder(s), the dividends bear no Canadian withholding tax.

The tax liability of a foreign business in connection with transactions through an agent often presents a problem. In general, it depends on the degree of control that the foreign business exercises over the agent.

For branches and subsidiaries of non-resident companies, profits are subject to Canadian tax in the same way that Canadian-owned branches and subsidiaries are taxed. Credits are usually allowed for Canadian taxes paid in the country of the parent. As far as Canadian practices are concerned, it is usually more satisfactory for foreign capital to operate through a Canadian entity rather than through a branch.

In the case of number 8, Canadian law would require a 15% withholding tax on any dividends remitted, but if no dividends were paid it would permit the Canadian company to be built up and later sold to the foreign company or to outsiders for a satisfactory capital gain.

With respect to number 9, there are probably no tax advantages to be gained by U.S. and U.K. residents, for the taxing statutes of those countries reach out to destroy the effect of the Canadian corporate facade. However, this situation might be useful if either a U.S. or U.K. resident and two

unrelated Canadian residents combined to strengthen the bonds of international cooperation by pooling their investment portfolios. In none of the countries would such a company be considered a personal corporation for tax purposes. The company could accumulate its income, involving no additional tax liability, and the shareholders could eventually dispose of their interest for a capital gain. Alternatively, this type of scheme might form the basis of a pension plan to defer income until the shareholders required it.

The U.S. tax status of a Western Hemisphere Trade Corporation provides a valuable incentive to U.S. companies selling to Canadian customers. Such a company, normally a subsidiary of a U.S. company, is allowed a special income credit which gives them an effective U.S. tax rate of 14 percentage points below the general rate of 52%. The second advantage is that neither a U.S. parent company nor a subsidiary is disqualified from using the reduced rate of tax on the first $25,000 of taxable income in the U.S.

A comparatively recent concession and similar to the foregoing has been made by the British Chancellor in respect of overseas trade corporations. Canadian subsidiaries managed in the United Kingdom may be included in this category. Now, only remittances from the Canadian subsidiary to the United Kingdom company are taxable in the United Kingdom whereas formerly the total profits were included in any assessment.

Special Allowances

Special provisions exist in the law for the extractive industries — oil, gas, and mining — in the form of a depletion allowance. These apply not only to operating companies, but also to investors not involved in the actual technical operations, irrespective of their residential qualifications. In the case of the oil industry, the allowance is not as far reaching as that allowed by the U.S. Internal Revenue Code, thus placing Canadian oil companies operating wells in Canada at a distinct disadvantage when competing on world markets. In Canada, the depletion allowance is administered on the basis of the net overall profit of the company reasonably attributable to the production of oil, while in the United States the basis is the gross income of each individual operation. Canadian oil companies have further complaint in respect of leases, for these are considered as capital costs in Canadian law, whereas U.S. companies under the U.S. Code are often prepared to pay more for a lease than a Canadian competitor can afford.

Allowances are available for exploration of new sites, and although not applicable to oil wells, new mines are completely exempt from tax during the first three years of production. These concessions have been introduced as a further incentive for foreign investment, and they help to open up this vast and relatively unexplored country and develop its basic industries.

U.S. and U.K. Investors

The main source of foreign investments at the present time are the United States and United Kingdom.

Under the bilateral agreement between Canada and the United States, the Canadian withholding tax on dividends paid to a U.S. parent company is limited to 5%. A stipulation is that the parent, either alone or in association with not more than three other

corporations of the U.S., etc., should own 51% or more of the voting shares of the subsidiary. Formerly, the figure was 95% but this acted as a brake on investment by Canadian citizens in companies resident and operating in Canada.

It is of interest to prospective U.S. investors to know that corporate and individual taxpayers are allowed U.S. tax credits in respect of Canadian withholding taxes. U.S. corporations may, in addition, obtain credit for the underlying taxes paid by Canadian subsidiaries, so long as the former, with any associates, hold at least a 51% interest in the latter. The U.S. tax credit allowed to the parent company is restricted to the U.S. effective rate, and so at present these provisions normally give full relief for Canadian taxes. However, as a result of congressional legislation provision has been made for a reduction of the U.S. corporate rate to 47% from 52% from June 30, 1958. The implications of this will be readily appreciated if, in fact, the reduction ever becomes a law, but in view of the recently increased defence burdens, it is a matter of speculation whether this will be implemented.

Regarding the type of organization of a business operating in Canada but owned by U.S. interests, perhaps the greatest saving in U.S. taxes is obtained, for a small concern, when the organization is able to take advantage of the lower rates of tax in both countries; and this is especially marked in the case of the "Western Hemisphere Trade Corporation". Accordingly, it is most advantageous to use this method of operation when the Canadian profits are low. As profits increase, the advantages diminish. For large profits it is more costly than a Canadian subsidiary.

Example

U.S. COMPANY OPERATING IN CANADA
COMPARISON OF TYPES OF ORGANIZATIONS

	Canadian branch of U.S. company		Canadian subsidiary of U.S. company		Western Hemisphere Trade Corporation — A subsidiary of a U.S. company	
Income from operations	$10,000	$100,000	$10,000	$100,000	$10,000	$100,000
Canadian income tax	2,000	41,600	2,000	41,600	2,000	41,600
5% withholding tax			400	2,920		
U.S. federal tax on W.H.T.C. less foreign tax credit					192	
Income to U.S. parent	10,000	100,000	8,000	58,400	7,808	58,400
U.S. federal tax less foreign tax credits	3,200	10,400	2,160	3,154	609	4,555
Total Canadian and U.S. taxes	5,200	52,000	4,560	47,674	2,801	46,155
Net return	4,800	48,000	5,440	52,326	7,199	53,845

Conversions from $ Canadian to $ U.S. are at par and 1957 tax rates are used. The U.S. parent is assumed to have other taxable income of at least $25,000. For simplicity, no account is taken of provincial taxes.

Assuming that Canadian profits are made, the foregoing indicates that a Canadian subsidiary of a U.S. company has a distinct advantage over a Canadian branch of a U.S. company but does not compare so favourably with the "Western Hemisphere Trade Corporation". U.S. speakers refer to the need for some revision of Canadian taxes, declaring that in particular U.S. concessions go further than similar concessions in Canada. It would seem that this is so for allowances of depletion, exploration and development expenses. However, U.S. companies, by operating a branch in Canada, may apply early years losses against U.S. income and thereby obtain the advantages of U.S. tax laws. When profits are expected, the Canadian branch could be incorporated as a subsidiary.

For U.K. companies, the same conclusions do not apply. Assuming that all profits of a Canadian subsidiary were remitted as dividends to the U.K. parent, there would be no tax advantage between a Canadian branch or subsidiary. The advantage of a subsidiary would lie in the deferring of U.K. tax on profits remitted compared to branch profits being taxed in the U.K. whether remitted or not.

U.K. companies doing business in Canada are, like those of U.S. origin, subject to a bilateral agreement between the two countries. An important feature of this provides for total exemption of withholding tax on dividends paid by a wholly-owned Canadian subsidiary to a U.K. parent company. The U.K. Finance Acts allow a tax credit against U.K. income tax, surtax and profits tax for Canadian taxes payable on income from sources within Canada. In the case of dividends on common stock, but not preferred, the tax credit takes into account both the withholding tax and the underlying taxes paid by a subsidiary. Should the Canadian company's income include dividends on common stock paid by Canadian or even foreign public companies, a tax credit might be claimed.

It is hoped that this summary of some of the tax factors affecting foreign businesses will promote interest in the subject, particularly among those who might be called upon to help solve the problems that are bound to arise. If Canada is to continue its present rate of growth along the present lines, it will continue to require foreign investment; the returns in the long run are certain to justify an investor's faith, although fluctuations in the buoyancy of the economy will occur at times.

THE SMALL STORE:

Merchandising Control

DAVID P. CRAWLEY

THERE ARE two main aspects of merchandise control: safeguarding the stock-in-trade against various forms of loss and maintaining the level of the stock-in-trade at adequate but not excessive amounts.

Merchandise losses may occur in the following ways:

1. Destruction by fire, water and smoke.
2. Theft by employees, customers or the public.
3. Spoilage of perishable goods.
4. Obsolescence of certain kinds of merchandise.
5. Falling prices.

In addition, serious losses can result through failure to maintain merchandise inventories at the level best suited to the sales volume for each of the various selling times and seasons throughout the year. They may also occur through not meeting sales requirements from day to day, and so causing individual "lost sales" and consequent loss of goodwill, or from carrying inventories in excessive amounts which result in unnecessary higher costs for insurance protection, storage space and interest charges. The carrying of excess stock may also contribute to losses through spoilage, obsolescence or ultimate fall in prices.

The important factors in the control of merchandise are:

1. Protection of the physical stock from theft and fire loss by the usual business procedures.
2. Adequate insurance coverage on all reasonable risks.
3. A properly regulated purchasing program geared to reasonable forecasts of sales requirements.
4. Adequate storage or warehouse facilities maintained in an orderly manner.
5. Adequate records with regard to purchases, sales and merchandise on hand.

The first two factors mentioned need no further explanation; the following comments are made on the others.

Purchasing Program

The need for merchandise control arises before the merchandise comes into the store. A buying program based on reasonable sales forecasts is the initial stage at which proper control should be introduced. In most stores, the purchasing requirements vary with the changing seasons and the types of merchandise handled. The buyer should have up-to-date information on the stock on hand and unfilled orders. To a certain extent the buying program can be based on

past experience as indicated by the merchandise records, but for the most part it depends on the merchandising ability of the buyer, coupled with a measure of "luck".

From week to week the operation of the sales forecast and purchase program should be reviewed and compared with sales results and adjustments, and revisions made.

Storage and Warehouse Facilities

It is essential that storage or warehouse facilities be adequate for the orderly storing and ready handling of merchandise. The need for good housekeeping is most important. Apart from fire hazards and spoilage of merchandise resulting from sloppy storing, there is the danger that certain stocks of merchandise will be lost in storage and will not show up until their season of sale is past.

Although the sales program can be seriously hampered through inadequate warehousing facilities, there is a danger in having more accommodation than the normal requirements because of the temptation to overload a spacious warehouse and thus increase carrying charges. As one shrewd merchandiser used to say of his sales-ambitious manager, "If I give him a big warehouse, he'll just fill it."

Inventory Records

Adequate records should be kept of purchases, sales and merchandise on hand, the extent being determined by the size of the operation, types of merchandise handled and cost of maintaining the system.

If the clerical and accounting cost is not prohibitive, the inventory records should be integrated with the general accounting system although an elaborate system may perform all the functions for which it is designed and yet defeat its purpose by costing a greater amount than the loss could possibly be.

Receiving Record

The receiving record furnishes pertinent particulars in permanent form of all goods coming into the store.

It is common practice to give one copy of the purchase order to the receiving department to check the goods received against the supplier's delivery voucher, bill of lading etc. An objection to this procedure is that there might be a tendency for the receiving clerk to do his work perfunctorily without actually checking and examining the goods received.

In some stores delivery is recorded by the receiving clerk without any examination or count being made, and then the goods are passed on to the merchandise department concerned where they are fully checked.

The receiving clerk records the date received, name of supplier, purchase order number, brief description of goods, including particulars of quantity received, etc.

Periodic Inventory Taking

Stock-taking in a retail store is a major operation and until a few years ago was considered a once-a-year proposition. In recent years, the practice of taking stock periodically throughout the fiscal period has increased. In a department store, inventory can be taken in several departments every month and by the close of the year all departments will have been covered a number of times.

For purposes of control, it is advisable to have two persons take stock

together, one calling the items of merchandise to the other who lists them and also checks the accuracy of the caller.

After the inventory has been taken, the sheets should be priced, extended and added and then reconciled with the book figures. If discrepancies are inquired into immediately, the effectiveness of the control will be readily apparent.

Control by Classification and Gross Margin Percentage

One method of merchandise control is to classify merchandise into departments and determine periodic inventories on a gross margin percentage basis. In carrying out this procedure, it is necessary to classify inventory accounts, purchases and sales by departments of merchandise, such as furniture, refrigerators, bedding, draperies, china, etc.

Estimated gross profit and cost of sales percentage figures are established for each department, usually based on the actual percentages as determined for the preceding fiscal period. The estimated cost of sales for any given period is then calculated by applying the cost of sales percentage to the sales of each department. Finally the estimated inventory is obtained by subtracting the cost of sales figures from the total of the opening inventory plus purchases to date.

It should be noted that the resulting inventory figures are only estimates, and allowances should be made for variance in gross margin percentages, mark-downs etc.

As periodic physical inventories are taken by departments, the total values should be compared with those of the estimated book inventories, and discrepancies of appreciable amounts should be investigated.

Control by Perpetual Inventory Records with Occasional Counts

A perpetual inventory record consists of continuous detailed records of merchandise units on hand, showing the day-to-day changes for incoming and outgoing stock. The more elaborate types of this system show the various kinds of stock by dollar value as well as the number of units. In other systems, only the dollar control is used. In addition to furnishing particulars of the daily transactions, most perpetual inventory systems provide space to show the maximum and minimum quantities which should be carried, and a variety of descriptive information regarding the merchandise units.

A perpetual inventory system provides the following advantages:

1. Merchandise control is greatly facilitated in that a large inventory can be broken down into numerous small categories which can be checked individually at intervals. Discrepancies can be discovered earlier and the problems of determining the causes thereof are more readily solved.
2. Management is furnished with invaluable information to help in planning the buying and selling programs and maintaining a well balanced stock.
3. Slow moving goods are quickly drawn to the attention of management and steps can be taken to correct the situation.
4. Preparation of monthly statements is facilitated considerably.
5. Stock is usually kept in better order and is more easily located.

An important point to bear in mind is that the system will lose its value if the records are not accurate and up-to-date. In this connection the sales department will have to exercise care to furnish all the particulars required concerning merchandise sold.

The perpetual inventory records can be integrated with the general accounting system, and the various inventory accounts can be balanced with the general ledger controlling accounts. However, in certain types of operation and with certain classes of merchandise, the cost of operating such a system would not be commensurate with the advantages gained. In such instances control can be effected by total dollar value.

Retail Inventory Method

In operations where the number of merchandise units is large and the sales volume comprises a great number of small transactions, such as in grocery or small wares stores, it is not feasible to control merchandise by a detailed record of the items concerned. In such cases, the control is usually maintained on the basis of the total sales value of merchandise in each department. This is known as the "retail inventory method".

In the operation of this method the inventory account for each department is charged with the total value at selling price of all goods put into stock, and is credited with the selling price of all sales. The inventory of any department can be readily checked in approximate totals. The quantities of stock on hand should be listed, the selling prices applied, and the total value thus determined. It should check with the department's book inventory, which would comprise the previous inventory, plus purchased stock, less goods sold, all at selling prices, taking into account adjustments for mark-ups, mark-downs and shrinkage. Some select goods may be marked up more than the normal percentage, and the style, season or prospective deterioration may call for decreasing the selling prices on other merchandise. These circumstances call for adjustments called "mark-ups" and "mark-downs" which are calculated and entered on the inventory sheets.

This system provides for a columnar merchandise ledger sheet for each department to record information along the lines of the following:

1. Purchases at cost including inward freight.
2. Purchases at retail – (Mark-up percent is obtained from purchase invoices).
3. Net sales.
4. Merchandise mark-downs (obtained from mark-down sheets prepared by departmental managers, and checked by the accounting department).
5. Shrinkage allowance (determined by management on percentage of sales).
6. Inventories at cost (obtained by converting inventories at retail to cost by applying mark-up percentage in item 2).
7. Inventories at retail (item 2, less items 3, 4 and 5).

When physical stock is taken, it is normal to expect differences between the book and physical inventories. These differences may be due to stock shrinkage or losses in cutting (e.g. drapery and carpets), theft of stock, errors in either book or physical inventories, etc. However, when related to sales and compared with reported figures for the trade, the dif-

ferences should indicate whether there is a normal reasonable shrinkage or whether the amounts involved indicate a serious shortage.

Pricing Inventories

In a going concern, inventories are most conservatively valued at the lower of cost or market price. Cost should include all costs involved in placing the merchandise in the store ready for sale. In cases where the store deals in large units such as furniture, household appliances and similar classes of merchandise, the laid-down cost is usually obtainable from the perpetual inventory records. In other cases where individual unit costs are not available and merchandise has been acquired over a period of time at varying prices, some means must be found for determining the unit cost.

Over the years several methods of valuation have been used to meet the requirements of different types of business operations. Once a satisfactory method of valuation has been adopted it should be continued so that the inventory will be valued on substantially the same basis from period to period.

In valuing at the lower of cost or market, such market price is usually regarded as being the replacement cost if the goods were to be purchased through the usual channels, in the usual quantities and under the usual conditions.

As soon as it is apparent that goods have decreased in value by being shop worn, inactive or obsolete, markdowns should be made in the appropriate inventory accounts, and the merchandise should be realized on as soon as possible.

Bulk Merchandise Problems

The major problems in connection with bulk merchandise arise in determining the quantities received, used and on hand from time to time. Liquids are subject to evaporation, and expansion or contraction in volume with changes in temperature. Other commodities, such as certain food stuffs, are subject to the absorption of moisture. It is not practical to weigh such assets as piles of coal at inventory-taking time, and quantities have to be estimated.

Each problem has to be treated separately. Although there will necessarily be considerable estimating of weights and volumes resulting in varying discrepancies, nevertheless reasonably effective control can be exercised.

Conclusion

Merchandise control in a retail store is needed and the aspects of establishing and maintaining such control with respect to varying sizes of business and types of merchandise should be reviewed by the merchandiser. It is recommended that he consult his auditor with a view to instituting and maintaining the system best suited to his needs.

Edited by LAWRENCE G. MACPHERSON, F.C.A.

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Prepaid Expenses and Deferred Charges

Gertrude Mulcahy, C.A.

The terms "prepaid expenses" and "deferred charges" are often used interchangeably. This is understandable as the assets are alike in that "both types represent portions of expenditures or accruals made prior to the balance sheet date that are proper charges to income in subsequent periods".[1] However, accountants and accounting authorities have recognized certain basic differences which distinguish these two assets and have recommended that this distinction should be recognized in financial statement presentation.

Basic Differences

Over the years, a number of characteristics have been emphasized as the distinguishing features of these two assets. A dictionary of accounting terminology, published in 1938 under the auspices of the then Dominion Association of Chartered Accountants, defines the terms as follows:

Prepaid expenses: "A term used on balance sheets to represent that portion of expenses paid in advance, the benefits from which are still to be obtained. It should only be used in connection with expenses which cover a definite period of time, and which thus will be charged into profit and loss within that period of time. . . ."

Deferred charges: "Expenditures made by a company or corporation which result (usually) in intangible benefits, these being either continuous or of an indefinite duration, e.g., preliminary expenses on incorporation, moving expenses, etc. Such and similar expenses are usually extinguished by appropriations as profits afford.

"The term should not be used for expenditures which have a definite value realizable in future periods, such as insurance premiums prepaid, rent paid in advance, etc.; these finally become charges to profit and loss in the period which they cover, and should be called 'prepaid expenses'."

These and similar definitions, included in other terminology booklets and textbooks, establish certain differences between the two assets. The first is their realizable value. Prepaid expenses have a definite going concern value which will be realized in succeeding periods. That is to say, there is still service or use to be derived from the expenses by the operations of future periods. In contrast, deferred charges lack this tangible quality and the benefits resulting therefrom are intangible.

The use of the word "expenses" in the first definition and of the word "expenditures" in the second brings

[1] "Montgomery's Auditing", 8th ed.

out another distinction. Prepaid expenses represent advance payments of costs which would be incurred in the process of earning revenue and in the ordinary course of operations in future periods. It should be noted that, if the prepayments were not made, actual cash outlays would be required at future dates to cover such costs. Deferred charges, on the other hand, are not related to costs essential to the ordinary course of operations. They are outlays made or liabilities incurred to obtain an asset or service which may reasonably be expected to help or improve future operations, but the failure to make such expenditures will not necessarily require future cash outlays.

The above definitions also bring out the fact that the benefits inherent in prepaid expenses cover specific periods of time, whereas those inherent in deferred charges are of either indefinite or lengthy duration.

There is also a difference in the reasoning applied in the setting up of these two assets on the balance sheet and their subsequent write off. Under the generally accepted principle of income measurement through the process of matching costs and revenue, costs and expenses which are chargeable against the revenues of more than one period should be apportioned, where practicable, to the periods involved. Accordingly, the carrying forward of prepaid expenses and their subsequent charge to profit and loss in the period which they cover is established by generally accepted accounting principles. Deferred charges, however, because of the intangible nature and indefinite duration of their benefits, cannot be specifically attributed to the operations of any particular period. Such expenditures might be written off when incurred and their deferment, to be written off in whole or in part at some later date, is frequently a management decision. Similarly, the subsequent assignment of such items to the operations of succeeding periods is often effected on an arbitrary basis at management's discretion. As stated in the above definitions, this may be carried out by "appropriations as profits afford". However, it should be noted that bond discount and expenses are usually amortized over the life of the related bonds, even though this may be a rather lengthy period of time.

More recent definitions and discussions have emphasized other distinguishing features of these two assets. In the definitions included in "Accounting Terminology", which was published by The Canadian Institute of Chartered Accountants in 1957, the emphasis is on the length of the period over which the benefits extend.

Prepaid expenses: "A short-term expense prepayment; an expenditure, other than a capital expenditure, which is expected to yield its benefits in the near future and meanwhile is carried forward as an asset to be assigned to expense in the near future."

Deferred charge: "An expenditure, other than a capital expenditure, the benefit of which will extend over a period of years from the time of occurrence."

Along a similar line, R. G. H. Smails suggested that "It would seem desirable to use prepaid expenses to designate service values which have not been used up at the date of closing but which will be used up (and hence realized upon) in the succeeding year. Deferred charges would then serve to designate service values

whose consumption will extend over more than one or two years."[2]

In his text "Financial Statement Analysis", J. N. Myer noted that, for practical purposes, a distinction between the two assets could very easily be made on the basis of the regularity of occurrence and relationship to operations. He stated, "The term prepaid expenses is usually used to designate the more or less regularly recurring items in connection with operations, such as insurance, supplies, rent, taxes, interest and so forth, while the term deferred charges is generally applied to the more unusual items, such as organization expense, bond discount and leasehold improvements."

"Montgomery's Auditing," 8th ed., published in 1957, included the following explanation: "Prepaid expenses are generally considered to represent the balance of amounts paid for services not yet received from the payee. . . . Deferred charges on the other hand usually represent the balance of amounts paid for goods or services which have been received and for which the payee has no further obligation." In this interpretation, the obligation of the payee, as at the balance sheet date, relative to specific expenditures distinguishes the two assets.

Designation of Specific Items

Obvious differences of opinion as to the distinguishing features of the two assets, brought out in the above mentioned definitions and discussions, may lead to variations in the designation of specific items as prepaid expenses or as deferred charges. For example, prepayments of such items as insurance premiums, taxes, rentals, commissions, etc., which would be considered prepaid expenses according to three of the references, may or may not be designated as prepaid expenses if the period covered was considered to be the sole distinguishing feature. Similarly, items such as organization expenses, discount on bonds, experimental, research and development expenses, leasehold improvements, etc., would become prepaid expenses rather than deferred charges if the benefits therefrom were expected to cover only a short period or to cease in the near future.

Inventories of supplies, such as stationery, heating fuel, and similar nonoperating supplies for use in the succeeding period or periods would be treated differently under the explanations set out in "Montgomery's Auditing", 8th ed., than they would be under the other interpretations. Because the goods have been received and the payee has no further obligations, such inventories of supplies would be considered to be deferred charges under the Montgomery interpretation. Under the others, because they represent definite tangible costs relevant to the ordinary course of operations in future periods and usually are short term prepayments, such inventories would be described as prepaid expenses.

Balance Sheet Presentation

Bulletin No. 1 of the Committee on Accounting and Auditing Research, released in 1946, recommended that prepaid expenses be shown separately from deferred charges and suggested that prepaid expenses may be classified as current assets. In Bulletin No. 14, released in 1957, the committee repeated this suggestion and recommended that deferred

[2] "Accounting Principles and Practice", R. G. H. Smails.

charges should not be classified as current assets, thereby giving recognition to the interpretation of deferred charges as long term prepayments.

The "Restatement and Revision of Accounting Research Bulletins," issued by the Committee on Accounting Procedures of the American Institute of Certified Public Accountants in 1953, recommended the inclusion in current assets of prepaid expenses, such as insurance, interest, rents, taxes, unused royalties, current paid advertising service not yet received and operating supplies. The basis for this classification was explained as follows: "Prepaid expenses are not current assets in the sense that they will be converted into cash but in the sense that, if not paid in advance, they would require the use of current assets during the operating cycle." In addition, the bulletin pointed out that "long-term prepayments which are fairly chargeable to the operations of several years, or deferred charges such as unamortized debt discount and expense, bonus payments under a long-term lease, costs of rearrangement of factory layout or removal to a new location and certain types of research and development costs" should not be included in the current asset classification.

It should be noted that although the Canadian bulletins suggested that prepaid expenses may be shown as current assets, the relationship of the particular item to future usage of current assets or cash outlays, as explained in the American bulletin, provides a readily available rule of thumb for determining whether or not a particular prepayment could properly be included in current assets. Generally speaking, a one-year period from the date of the balance sheet or the normal operating cycle, where that is longer than a year, is used as the basis for segregation of current assets. However, with respect to prepayment of expenses extending over more than one year or operating cycle, it has become general practice to include all of the prepayments in current assets, if a material portion of the prepaid expense will be absorbed within the next year or operating cycle. This practice is acceptable only as long as it does not significantly distort the working capital picture presented in the statements. If the non-current portion were so large that its inclusion in current assets would distort the working capital, the prepayment should be shown partly as a current asset and partly as a non-current asset.

The 1957 edition of "Accounting Trends and Techniques" published by the American Institute of Certified Public Accountants presents a summary of the practices followed in the balance sheet presentation of the two assets, as disclosed by a survey of published annual reports of American corporations. "Of the 600 survey companies, 588 presented prepaid expenses or deferred charges in their 1956 balance sheet. Of the 588 companies displaying such items, 201 companies presented them under 'current assets', 107 companies presented them under both 'current' assets and 'non-current assets' and the remaining 280 companies included them among the 'noncurrent assets'".

A review of the terminology used and the types of items included in the current asset and noncurrent asset section, disclosed a definite trend towards the acceptance of the recommendations that prepayments of or-

dinary operating expenses be included in current assets and that deferred charges be classified as noncurrent assets.

Table 18 of "Financial Reporting in Canada" shows the practices used by Canadian accountants and the extent to which the recommendations of Bulletins Nos. 1 and 14 as to segregation and classification have been followed. The statistical tabulations and discussions disclosed that 54% of the balance sheets for 1956, showing both prepaid expenses and deferred charges, clearly separated and adequately identified the two types of assets as recommended in Bulletin No. 1. In 19% of the balance sheets concerned, the individual items were segregated but were set out under a common heading but in 27% a single figure was shown described as "Prepaid expenses and deferred charges".

As to classification procedures, 81% of the balance sheets showing only prepaid expenses or showing prepaid expenses separately from deferred charges included the prepaid expenses in current assets, and 93% of the balance sheets showing only deferred charges or showing deferred charges separately excluded the deferred charge from current assets. In 90% of the cases in which the two types of assets were grouped either in one figure or under a common heading, classification as a noncurrent asset was followed.

Edited by GEOFFREY H. WARD, C.A.

Practitioners Forum

LETTERS TO DIRECTORS

Why are they important?

The one part of our work which all clients see is our written report, and the part of the report that provides the greatest scope for originality is the letter to the directors.

To some extent the package is standardized; most contain an auditor's report, balance sheet, statement of surplus, statement of operations, and, where appropriate, departmental statements and schedules of expenses. Other statements commonly included are the statement of source and application of funds, analysis of changes in net income, schedule of investments and schedule of fixed assets.

Only the letter offers flexibility of format. Accordingly, here is the accountant's opportunity to excel in maximum service to management. A written record is important as a means of communication, a summary of the extensive examination and considered opinions of the auditor, an agenda for discussion, as well as evidence of the valuable contribution made by the auditor.

Why write a letter?

Current practices of accountants vary from the one extreme where no letter is prepared to the other where the letter is 20 or more pages.

The auditor may feel that a letter is not required by the terms of his engagement or, due to the nature of the work, is unnecessary; or he may prefer to make his supplementary report verbally during a personal discussion with the management or at a board of directors meeting. A member of a well known firm comments: "A lengthy letter accompanying annual financial statements may seldom be read. Before a letter is written, it would probably be advisable to enquire whether there is any desire for it on the part of those to whom it is directed. Some auditors in recent years have greatly reduced the length of their comments as, on enquiry, they found that the client did not need detailed comments. Maybe the client prefers the auditor to use his time in other ways, such as discussing suggested improvements in the accounting procedures. The source and application of funds statement, which is often very useful, might be better as a separate sheet with the financial statements rather than included in a long comments section where it may not be carefully read."

Many accountants prefer to make their report in writing because it provides some tangible evidence of the work done and leaves a permanent record for subsequent reference. Frequently, it may not be practicable to speak to all the persons for whom the report is intended. In addition to the directors and management, the banker, creditors, prospective investors or purchasers of the business may wish to study the report.

To whom are we writing?

The following discussion is based on the needs of medium-sized businesses where the ownership and management are not identical and where the internal reports are not completely adequate. Smaller businesses, where the ownership and management are the same, would require reports tailored more to the needs of the particular business and the background of the owner. Larger businesses, with competent accounting staffs, would generally require fewer details to supplement the formal audit report. As a matter of historical interest, details of the make-up and condition of balance sheet items, and changes in the non-current items during the year might be included.

What difficulties are there?

One of the speakers at the 1954 annual meeting of the American Institute of Certified Public Accountants stated: "The comments we make on balance sheet accounts furnish a real opportunity to make ourselves valuable to the reader of the audit report. And it is in this field that it is useless to try to establish a formula, for here is where the boys are separated from the men. Full and complete disclosure of the content of and facts behind each major item in the balance sheet is certainly required. But the pertinence of the comments and clarity of the presentation will measure its value to the reader."

Accordingly, while office memoranda will give guidance as to what should be included, they are not a substitute for judgment. The partner and audit senior working on each engagement must decide the nature of the comments in accordance with the client's needs and the uses to be made of the report. They must take into account all the pertinent facts and intelligently apply the policies and examples given in the office memoranda. Nevertheless, as much guidance as is practicable should be provided. Report writing is made easier if examples and clear statements of policy are available.

How can policies be implemented?

In a small accounting firm where a partner writes the reports himself there is no problem to implementing policies. In practice many firms prepare their reports by copying from the previous year, making such amendments as are obviously required. In this event, once a partner has thoroughly revised a client's report to comply with the firm's policies it will be an acceptable model of conformity to office policy. However, there are many obvious disadvantages to this procedure; it is too rigid and results in a report that looks like and is a mere copy of the previous year's.

Many of the larger firms have staff manuals, dealing with form and content of reports. In a larger organization, where the partners do not do much of the actual audit work and it is necessary to delegate the preparation of reports, some formal instruction is advisable.

An actual example of how policies are implemented may be of interest. Our firm has a nine page memorandum setting forth our policies regarding what is to be included in reports to clients. Some of the items are mandatory; some are merely considered desirable; and some are strictly optional. In any case, the content of each report must be carefully considered to best meet the client's needs, as well as fulfil the statutory require-

ments, cover our interests and be useful to other parties, such as bankers or income tax assessors. In addition to this statement of policy, we have several specimen reports in the staff notebooks.

Of course, on each audit the procedure and report for the previous year are considered. We must understand why each item was included or why usual comments were omitted. There is a certain merit in varying from the previous year, particularly in the wording, so that reports will not appear to have been copied from the previous ones.

This combination of policy statement, specimens, previous year's example and review by a partner is quite effective in the economical production of statements which are of a high standard and uniform in format.

What should we include?

One of the main problems when preparing a guide for staff is deciding what to include in the letter to directors. Some indication of what we consider appropriate can be given by quoting some paragraphs from our staff notebooks.

As to comments on "auditing procedures": "These are usually not too important to the client and need not be included unless specially requested. However, bankers may be interested in procedures on receivables and inventories. Accordingly if the report is a major factor in obtaining credit these audit procedures should be given some emphasis. Also to protect ourselves, mention any restrictions or limitations in our examination. We should, of course, mention any discrepancies brought to light by the audit."

Under the heading "Useful to Management": "Endeavour to make sure the comments will be read and appreciated, otherwise it is wasteful to make them. On the one hand give a short report in the interests of economy, on the other hand make as complete comments as will be useful. The reading over of the draft report with management is done to make sure the client will be satisfied.

"All the information required for the proper management of the business should be included, unless we know that management have already received similar data from their own accountant. The annual statements prepared for the shareholders are usually condensed, as their purpose is to give a concise and clear picture to the owners. On the other hand, management require more details as to expenses and balance sheet items, with comparisons and ratios. We should interpret the statements so that their message will be clear to the Board and management."

You will notice the reference above to reading over the draft statements with management. We usually do this in addition to presenting the final report to a board meeting.

The form can be standardized fairly readily. In our case the style of writing is rather formal as these reports are considered to be official. However, we try to avoid unnatural or stilted phraseology. Simple language is used. Specimens of appropriate wording covering situations frequently encountered are included in the staff notebooks. Usually we have a separate paragraph for each significant balance sheet item.

How many letters?

One of the problems of the policymaker when deciding on contents of reports is whether to attempt to combine, in the one annual letter on the

accounts, all matters to be reported to the client. Comments will include explanations of audit procedures, historical data, recommendations on the accounting system and recommendations regarding operations. Some comments are intended for the management, some for the directors, some for the bankers and some for several of these people. Some require action on the part of the reader, while others are a matter of record only.

As a practical matter, it is difficult to separate different types of comments; it will also take more time to write separate letters. For example, one item of information, an accounts receivable analysis by age, is pertinent to: (1) comments on the adequacy of the allowance for bad debts, intended primarily for the banker; (2) recommendations as to the establishment of new credit policies, intended for the directors; (3) criticisms of the enforcement of collection procedures, intended for management. The aged analysis itself is historical data by the time the report is finalized. Obviously this is an item that virtually defies any efforts *not* to combine comments of different types without duplication.

Quite often it will be convenient to write a separate letter to the management on matters regarding the accounting system. A separate letter might be written for the management and board of directors on recommendations regarding operations of the business, particularly if special problems exist that have been studied by the auditor. However, this special area of management consulting advice is usually handled by the smaller firm in a verbal discussion with a partner; by the larger firm by a separate department.

There are some advantages to keeping the different types of comments separate. It would help to clarify their nature and purpose and would be more convenient for some of the readers. Another point, which perhaps should not be mentioned, is that it would also make it practicable to keep critical comments confidential from certain parties, such as the bank and the tax department.

* * *

Panel member George F. Abbott of Montreal made many valuable suggestions on the draft of this column.

Obviously this is a subject in which further study and research would be profitable. These are some of the books on report writing:

(1) Accountants' Reports, W. H. Bell; Ronald Press.

(2) Accountants' Writing, J. M. Clapp; Ronald Press.

(3) Long-Form Report Practice, American Institute of Certified Public Accountants.

(4) Report Writing, Guam, Graves, & Hoffman; Prentice-Hall.

(5) Report Writing for Accountants, J. M. Palen; Prentice-Hall.

The editor of Practitioners Forum would be glad to receive correspondence from his readers on any matter of concern to practitioners.

Edited by CAMPBELL W. LEACH, C.A.

Tax Review

Deductible Expenses

An encouraging note to harassed taxpayers is contained in a recent judgment of W. S. Fisher, Q.C., of the Income Tax Appeal Board. The case at issue (*M. E. Hodgins* v. *M.N.R.*) concerned the deductibility of expenses incurred by the appellant on a trip to Germany in an unsuccessful attempt to obtain the sales agency for a special kind of saw. In allowing the expense, Mr. Fisher said:

"A very considerable number of cases are coming before this Board in which taxpayers are claiming deductions for expenditures which were incurred in a bona fide manner for the express purpose of earning income but which have been disallowed as deductions by the taxation officials, either on the ground that, in their opinion, they do not come within the exception contained in section 12(1)(a), or on the ground that such expenditures can be brought within the provisions of section 12(1)(b). In view of the fact that more and more of these cases are being brought before this Board for decision, it seems to me that it should be recognized that, except in very rare instances, taxpayers in business do not throw their money around, or make unnecessary expenditures merely for the fun of getting rid of their money, or even, to take an extreme case, for the purpose of avoiding payment of income tax on the ground that the expenditure of the money will be deductible for income tax purposes and may, at the same time, benefit their business indirectly through the creation of good business relations or by producing some similar result. I feel, therefore, that some consideration should be given to the premise that taxpayers in business should be the best judges of whether an expenditure will or will not be beneficial to the earning of income from their business, and that therefore the deduction or otherwise of these expenditures should be approached from another angle than that which appears to be the present attitude in relation to this question. If it were recognized that the primary consideration in dealing with the deductibility or non-deductibility of business expenditures is whether or not they are made for the purpose of furthering the business activities and of earning or producing income from the business, and that the disallowance of items of expenditure incurred in the purchase of capital assets, or expenditures relating to capital, is a secondary or subsidiary idea to be adopted with regard to expenditures which do not conform with the primary idea, it would seem to me that a much healthier atmosphere would be created within which to deal with these matters than is created by the more or less negative procedure presently in force that all expenditures that are considered to be even remotely or indirectly connected with capital ex-

penditure are to be disallowed and only those that can be proven to have been made wholly and exclusively for the purpose of gaining or producing income will be allowed."

Mr. Fisher went on to explain that, although there were some doubts as to the propriety of a member of the Board expressing such an opinion, he felt that he was perfectly entitled to do so as the Board is not, in fact, a court. Furthermore, he indicated that in the past such expressions of opinion had been made and in some cases these comments and suggestions resulted in parliamentary amendments to the law. While no direct inference can be drawn that he would like certain amendments to the law, it may perhaps be taken that his comments were intended as a mild rebuke to certain over-zealous assessors who are inclined to be dogmatic in their appraisal of business expenditures.

It is not to be denied that an efficient and equitable tax system requires an efficient assessment division, but it is also true that efficiency should be coupled with common sense and an appreciation that expenses are usually bona fide unless the principals obtain some personal benefits. After all, even if deductible, an outlay will still cost the corporate taxpayer 53c on the dollar. In certain instances it would be better for all concerned if assessments were made with business and accounting practices in mind, rather than a tendency towards highly personalized interpretations of what constitutes a deductible expense for tax purposes. It would seem desirable to prevent, wherever possible, widening the gulf between income for accounting purposes and tax purposes. Otherwise the determination of income for tax purposes becomes so artificial as to increase the natural animosity of many taxpayers towards tax collectors generally, even though the majority of them are conscientious and reasonable.

RECENT TAX CASES

Merits of Tax Planning

Two cases heard by the Exchequer Court definitely show the merits of tax planning when unusual transactions are being contemplated. Two companies, Oxford Motors and Plimley Automobile, imported and sold English cars. Apparently business was poor and each company found itself unable to pay the balances due to its English suppliers. In any event, Nuffield Exports Ltd., who supplied Oxford, agreed to give Oxford a rebate of $250 on each vehicle in Canada. On the other hand, The Standard Motor Co. Ltd., who were the suppliers of Plimley, agreed to cancel 15% of the amount owing as a forgiveness of debt. The Minister of National Revenue sought to tax both these amounts. The Exchequer Court ruled that in the first case (Oxford Motors), the rebates constituted taxable income as they were a unitary allowance tacked on to each separate sale which operated to broaden the margin of profit. The court ruled in the Plimley case that the amount was not taxable as the transaction had the characteristic traits of a forgiveness of debt. (*Oxford Motors Ltd.* v. *M.N.R.* and *Plimley Automobile Co. Ltd.* v. *M.N.R.*)

Damages for Infringement

The appellant company produced women's clothing which bore a trade mark owned by the appellant. When

one of the executives resigned, he agreed not to do anything which would adversely affect the rights or interests of the company, but he subsequently manufactured similar garments using the appellant company's trade mark. Court action was taken and damages of $20,000 were awarded to the appellant which the Minister sought to tax. In dismissing the appeal, R. S. W. Fordham, Q.C. of the Income Tax Appeal Board stated that "Appeals of this kind can occasion considerable difficulty, as therein the dividing line between income tax liability and escape therefrom is not always discernible". He ruled, however, that as the damages were apparently awarded to compensate the appellant for the business it had lost and as no reference was made to any capital asset, the damages received must be viewed as income in its hands. (*Donald Hart Ltd.* v. *M.N.R.*)

Allowance? — Then No Expense

The appellant salesman was paid on a salary plus commission basis and, in addition, received a travelling allowance. In his tax return, he included the amount of the travelling allowance in his income and then proceeded to claim deductions for automobile expenses, capital cost allowance, entertainment expenses, telephone expenses and the cost of maintaining an office in his own home. The Minister excluded the travelling allowance from the appellant's income and denied the deduction of any of the expenses. The Income Tax Appeal Board admitted that the expenses were incurred for the purpose of increasing sales and thereby increasing the appellant's income but dismissed the appeal on the grounds that, because he was in receipt of a travelling allowance, he was not permitted to deduct any expenses. (*No. 534* v. *M.N.R.*). In this connection, reference may be made to the *Tax Review*, April 1958.

Payoffs

The Toronto Musicians' Association placed a radio station on its "unfair list" as a result of the station hiring certain musicians at less than the regular and authorized pay scale. As a result, the radio station was unable to obtain the services of any musicians belonging to the American Federation of Musicians of the United States and Canada. Several years later it became expedient to get back in the union's good graces as musicians were required for a new customer. Consequently, the station arranged a settlement with the union whereby it paid to the union an amount of some $7,800 of which $7,100 represented the amount by which the musicians had been underpaid in the previous years. The Minister disallowed the deduction but the Income Tax Appeal Board permitted it, arguing that the amount paid, or at least the major portion of it, represented back wages that should have been paid to the musicians and that if it had actually been paid at the time, no question as to its deductibility would have arisen. Furthermore, the money was paid by the appellant to make possible the continuance of the operations by which the income of its business was produced. As to the balance which represented legal expenses, etc., incurred by the union, there was no problem as they were considered to be in the same category as the wage arrears — a cost of remuneration. It is interesting to note that none of the amount was paid to the musicians who had been

underpaid in the first instance but this fact did not appear to alter the nature of the expense. (*No. 535* v. *M.N.R.*)

Loan to a Shareholder

In order to escape the tax on loans to shareholders, the appellant caused the company of which he was the controlling shareholder to assign to its subsidiary the amount which it had loaned to him. The Minister nevertheless treated the amount as a dividend to him and, in addition, levied tax upon an additional loan which was used by him to purchase a dwelling but which was not repayable for sixteen years. In upholding the Minister, the Income Tax Appeal Board ruled that, although the first loan was assigned to the subsidiary, it was nevertheless originally a loan to him and the assignment did not constitute a repayment and the amount was therefore taxable. With respect to the loan to purchase a dwelling, the Board ruled that the repayment terms could not be considered as being bona fide arrangements for repayment within a reasonable time. (*Gauthier* v. *M.N.R.*)

Sales Tax and Headache Pills

According to the Excise Tax Act, federal sales tax is to be paid by manufacturers on "the amount charged as price" for their products. The fact that a manufacturer may sell his product to a wholesaler at a lower price than to a retailer apparently was overlooked when the legislation was originally drafted. Fortunately, the Customs & Excise Branch of the Department of National Revenue has seen fit to so administer the Act as to avoid the inequity of identical articles bearing different taxes because they are sold to different types of distributors or direct to consumers. On the presumed assumption that the tax was meant to apply at the wholesale price level only, the Department has over the years sanctioned methods whereby actual selling prices are reduced to wholesale levels. For certain industries discount percentages are fixed by regulation to reduce selling prices to retailers and consumers to wholesale prices. Where a manufacturer accounts for tax on such discounted prices, he is said to operate "an unlicensed wholesale branch".

From time to time, lawyers have expressed the opinion that such regulations are *ultra vires*. Most taxpayers are probably not too concerned over the legality of such regulations. More likely their protests will be concerned with the inadequacy of the discounts or that the discount was incorrectly applied by the Department. One such protest arose in the case of Laboratoires Marois, Limitee.

Laboratoires Marois, Limitee manufactured drugs which it sold exclusively to retailers through its own wholesale branches. In respect of drugs, pharmaceutical preparations, propriety and patent medicines, etc., Circular No. 782C provides that:

> Where the manufacturers do not sell to independent wholesalers . . . licensed manufacturers may transfer their products to their unlicensed wholesale branches at the regular list selling prices to ordinary retailers who do not obtain any preferred prices or special discount of any kind, less 20%, the sales tax at the current rate to apply on the remainder.
>
> *Note*: Allowances for prepaid transportation charges and/or cash discounts or any other allowances may not be deducted in addition to the 20% discount.

Assuming that the "sales tax included" selling price of the manufac-

turer is $100, it is contended by the Minister that the tax should be calculated as follows:

($100 less 20%) X 10% = $8.00

Laboratoires Marois, Limitee disagreed and said that the formula to be used was:

$$\left(\$100 \times \frac{100}{110}\right) \text{ less } 20\% \times 10\% = \$7.27$$

The purpose of the fraction 100/110 is to remove the tax included in the selling price before taking the 20% discount. However, the Minister said that this was tantamount to an allowance and the regulation stated that the discount was to be applied to the regular list selling price without "any other allowance".

This disagreement was carried to the Supreme Court of Canada where three of the five judges sitting disagreed with the Minister's method. However, the Crown, like a resourceful poker player, was prepared to use every card, including the joker. Apparently with a complete lack of embarrassment, it also argued that the regulation permitting the use of the formula was null and void because it went beyond the powers conferred on the Minister by the Excise Tax Act. Two of the judges who ruled that the Minister's method of calculating the discount was wrong agreed with this contention. Of the other three, one made no ruling and two held that the regulation was valid. Consequently, four of the five judges agreed with at least one of the two arguments advanced by the Crown and allowed its appeal.

To sum up, the taxpayer was forced to compute his tax according to a formula which three out of five judges considered incorrect because two of those judges agreed with the Crown that the formula was contained in a regulation issued by the Crown, which is invalid. The validity of the regulation has not been decided, however, since the Supreme Court was evenly divided on the question.

The taxpayer deserves the sympathy of those who believe that both sides should observe the rules of the game. (*The Queen* v. *Laboratoires Marois Ltee*)

Permanent Establishment

The appellant company employed a sales representative and junior salesmen in the Province of Quebec and claimed a provincial tax credit for the Province as though it had a permanent establishment therein. The Quebec representative maintained an office in his home where he kept sample appliances, interviewed customers and consulted with the junior salesmen. In addition, during part of the period in question the appellant company rented space in a general warehouse. The Income Tax Appeal Board found no difficulty in overruling the Minister and finding that the company did, in fact, have a permanent establishment in Quebec during the whole period. (*No. 536* v. *M.N.R.*)

BY PETER C. BRIANT, M.B.A., C.A.

Current Reading

BOOK REVIEWS

"Cost Accounting and Control", by Cecil M. Gillespie; Prentice-Hall, Inc., Englewood Cliffs, N.J., 1957; 824 pages; $7.95.

This 30-chapter text in cost accounting treats subjects classified in four general areas. After an introductory chapter concerning the general nature and breadth of the field of cost accounting, 14 chapters are used to explain and illustrate accounting procedures for material, labour and factory expenses; for job order and process costing; and for by-products and joint products. A second section, comprising 7 chapters, deals with techniques for control of production, administration and distribution costs using estimates, standards, and flexible budgets. The next 7 chapters under the heading of "costs for use in business planning" treat the problems of cost-volume-profit relationships, comparative distribution cost analysis, and special purpose costs. A final chapter is devoted to cost planning and costs for government projects. Appendices include a complete set of cost reports, a complete illustrated budget, and an annotated bibliography on distribution costs. Discussion and review questions, exercises, and problems follow each chapter.

Professor Gillespie has used a hypothetical company to illustrate techniques throughout the text. This provides a degree of coherence which should aid the student in grasping the significance of specific techniques in the overall framework of cost accounting and control functions.

"Cost Accounting and Control" is unusual in its liberal use of charts, schedules, reports, and other visual aids. Some readers might find these rather detailed exhibits useful as a reflection of actual practice. It seems to this reviewer that others, perhaps a minority, may find the amount of detail somewhat distracting to an attempt to grasp the fundamental ideas presented. More concern is shown for the "how" rather than the "why" of cost accounting.

The latter half of this text includes numerous documented quotations from recent accounting literature. These should be useful in encouraging students to study further subject areas in which they find a particular interest.

The breadth of coverage of this text, the wealth of illustrative material included, and the generally good organization and presentation, make "Cost Accounting and Control" a valuable addition to the cost and management accounting field.

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"The Fundamentals of Accounting" by Donald H. Mackenzie; published by Brett-Macmillan Ltd., New York and Toronto; 742 pages; $6.25.

The twentieth century has witness-

ed a remarkable transformation in the popular image of the accountant. At the turn of the century he was a bookkeeper, complete with green eye shade, nib pen behind the ear, and a perch on a high stool. In the thirties he was the financial wizard, dull in appearance, unimaginative in expression, but artful in the mysterious production of profits and losses. Now in the fifties he has become the executive accountant, grey-flannelled, interested in people, and intimately involved in the planning and control of the use of company resources. This transformation of status has been reflected in the approach and emphasis of accounting textbooks. Early texts were largely concerned with the rules and procedures of double-entry bookkeeping. This concern with double-entry was then superseded by concern with problems of valuation and, as a result, there was an almost blanket adoption of the static balance sheet approach, an approach reflecting the problems of public auditing. Now, however, because of the overflow of accountants from the static world of the auditor, and his interest in the events of the past, to the dynamic world of the executive and his interest in the uncertainties of the future, a further shift of textbook emphasis is appropriate. The late Professor Donald H. MacKenzie in "The Fundamentals of Accounting" furnishes a worthy pattern for the new approach.

His book, which is intended as a first-year text, is not a complete break-away from the traditional approach. The 37 chapters include as thorough a coverage of the methods and procedures of elementary accounting as other textbooks. The book differs, however, in the focus of its chapter topics and in the organization of the chapter sequence.

Believing that students who are not going to specialize in accounting get more benefit from learning how to use costs than from learning how to record them, the author has made ample provision for those who may wish to stress the analytical and interpretive aspects of costs. He has also made his material as flexible as possible by providing, in topics such as accounting techniques and corporations, survey chapters followed by chapters dealing with the topic in detail. As a result, the reader can omit all but the first chapter on the topic without losing the continuity of the book.

Thus, depending upon his class objectives, the instructor who uses this book can give his teaching the weighting he desires – accounting techniques or accounting analysis.

Never having used the latter approach in a first-year class, this reviewer is intrigued by its possibilities and puzzled by some of its problems. Only a minority of those students studying elementary accounting today are likely to make accounting their livelihood. But all students are likely to use accounting information in the future. Therefore, there is a strong case for stressing how to use such information. However, this information is likely to be used in a dynamic setting, in circumstances where economic relationships are continually changing. This dynamism, with its resultant uncertainty, causes judgment to play a critical role in decisions. The essence of judgment in handling accounting data is a thorough appreciation of how accounts are affected by various transactions and an equal appreciation of

the limitations of the data furnished by such accounts. That students can learn to analyze activity successfully without first acquiring a thorough grounding in the techniques of recording, therefore, has still to be proved.

But experiments in the pattern of textbook approach have to be a prelude to such proof, and it is an encouraging sign that some authors are attempting to get off the broad highway of the balance sheet approach and explore new roads leading to the shifting citadel of accounting.

CALVIN C. POTTER, PH.D., C.A.,
Hamilton, Ontario

"Canadian Income Tax Appeal Board Practice," by R. S. W. Fordham, Q.C., LL.B.; published by CCH Canadian Limited, Toronto; 193 pages; $6.00.

Mr. Fordham's new and enlarged edition of this practical and informative book which was originally published in the fall of 1953 is most welcome.

Although many people are vaguely aware of the purpose of the Income Tax Appeal Board, a much smaller number appreciate its function, how it operates and why over the years it has established itself as an important part of our judicial system. If it is to continue the purpose for which it was originally conceived and to remain a strong rung in our judicial ladder, it is important that its role be well understood, not only by lawyers, but by accountants and others concerned with income tax matters.

There would appear to be a growing tendency to bypass the Appeal Board where taxpayers and the Department of National Revenue reach an impasse over an important issue. It is questionable if this is a healthy development and Mr. Fordham's book affords access to information which permits a more informed opinion on this matter.

The subject matter of the book is not confined to matters pertaining specifically to the Appeal Board and has a new chapter on appeals to the Supreme Court of Canada in addition to the chapter on appeals to the Exchequer Court which appeared in the first edition. Many new cases are cited and discussed and changes in the Board's practices have been noted. It is to be expected that this new edition will be well received by the owners of the first edition and, due to the increasing interest in income tax generally, it is probable that it will be of interest to a much wider public. The proposed Estate Tax Act should also serve to increase interest in this book since it provides that appeals in connection with estate taxes may be taken to the Income Tax Appeal Board.

Of interest to all taxpayers will be the statistics contained in the back of the book which show that of 2,629 cases heard by the Income Tax Appeal Board for 1949 to June 30, 1957, 1,534 or 58% were decided in favour of the Minister, while 1,095 or 42% were in favour of the taxpayer. Of 373 appeals received in 1956, by far the largest number, 164, came from Ontario, with British Columbia and Alberta tied for second place with 59 apiece, while Quebec came a close fourth with 55.

Mr. Fordham deserves a vote of thanks for taking time off to revise the original text. Too often, books of this type are allowed to become out of date.

D. R. HUGGETT, C.A.,
Montreal, Quebec

"Internal Auditing," 2nd Edition, by Victor Z. Brink, C.P.A., revised and rewritten by James A. Cashin, C.P.A.; The Ronald Press Company, New York, 1958; 428 pages with appendices; $6.75.

The authors have prefaced their book with a statement of its objectives: firstly, to be of practical use to internal auditors and those associated with that field and, secondly, to provide insight into and understanding of the potentialities of internal auditing as a major tool of effective management control.

The book has succeeded admirably in both objectives. As a reference book for those responsible for formulating internal auditing policies and procedures, it should be required reading; as a means of developing interest in and insight into the potentialities of internal auditing, its study by internal auditors will provide a basis for a more effective selling job to company management.

Detailed techniques of internal auditing have been covered only briefly, on the assumption that readers will be familiar with this phase which is common to all auditing, although its treatment of general considerations of approach and control has been supplemented by a number of representative internal audit programs drawn from actual practice.

Chapters are devoted to the approach to internal audits of specific assets and liabilities, income and expense, and other items of an operational nature. The general considerations related to each project are developed thoughtfully, and the authors have very carefully refrained from dogmatic statements which could easily have resulted from their many years of practical experience. The general considerations are further developed in each chapter by the inclusion of representative internal audit programs. The appraisal activity, which is a vital part of the internal auditor's worth to management, is fully outlined under each general subject.

The book is an excellent source of reference, and a well-designed general index and topical index add to its value.

W. A. Critchley, C.A.
Toronto, Ontario

"Canadian Monetary, Banking and Fiscal Development," by Professor R. Craig McIvor, M.A., Ph.D.; The MacMillan Co. of Canada Ltd., Toronto, 1958; 263 pages; $4.75.

This book is written for the serious student rather than for the layman looking for easily read history. As the author says, students of Canadian monetary, banking and fiscal development have had to refer to texts on foreign banking and monetary theories and then attempt to relate these to the conditions peculiar to Canada. This gap the author has succeeded in filling very creditably.

The material has been grouped into several natural periods beginning with the problems of the early French settlers and ending with the tight money conditions of 1957. In each period the changing economic background is sketched out and against this is shown the attempts made by individuals, governments, banks and other financial institutions to meet the demand for currency, specie and capital. The author deals with the various monetary theories tried out from time to time and explains why they succeeded or failed.

It is interesting to reflect on how

new some elements of the financial system are. The first domestic bond issue was floated in 1915 and surprised the government with its success. A central bank was not established until the great depression of the 1930's made it clear that something of the kind was needed. In 1956 there was the first major test of the central bank as an agency for combatting inflation, and its efforts in this direction have shed light on the important part now being played by finance companies and other non-banking institutions as sources of credit.

The book is well annotated, nearly every page carrying footnotes which provide additional commentary or refer to supplementary reading. The reader may be confused at times by abrupt changes of subject, a difficulty that might have been overcome by a judicious use of sub-titles. These, however, are available in the excellent table of contents found at the front of the book.

R. E. Saunders, C.A.
Toronto, Ontario

"High-Speed Data Processing," by C. C. Gotleib and J. N. P. Hume; McGraw Hill Co. Can. Ltd., Toronto, 1958; 338 pages; $10.95.

Data processing using electronic computers is a subject which has received wide coverage by authors and speakers in the past decade. At first, it was dealt with only in general, but very optimistic, terms. Currently, data processing is becoming better understood, this extending to the limitations and problems as well as to the advantages. It is, however, still questionable whether there is a real understanding of the true significance of electronic data processing by the business community.

It is, therefore, encouraging to read a book which sets out concisely and logically the operational principles of high-speed data processing and which includes references to such applied techniques as operations research. The text is complex, containing many mathematical formulae and references not readily understandable. Without these, however, it would be difficult to cover the subject fully in a text of just over 300 pages.

The book presents a logical development of data processing, covering the basic principles underlying the operation of electronic computers for commercial purposes. The chapters on analyzing, programming and coding are particularly clear. The authors in their treatment of the subject reveal an unusual understanding of business problems.

Individual accounting and commercial applications are illustrated only in the broadest terms. The accounting profession would have benefited more by an expansion of these application illustrations both in number and content.

While involved, this is nevertheless a useful contribution to the field. It seems probable that it will appeal to accountants who find it necessary to acquire a detailed knowledge of the subject or to those with a keen interest and appreciation of what electronic data processing has to offer.

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BY J. E. SMYTH, F.C.A.

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Students Department

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Final Examination, October 1957

Auditing I, Question 4 (14 marks)

The management of B Co. Ltd. advises CA, the shareholders' auditor, that it has been suggested that accounting machines should be installed in the general office to replace manual procedures. The management has asked CA for assistance in determining whether or not such a change would be advantageous.

Required:

List the factors that CA would suggest that management should take into account in deciding whether or not to install accounting machines to replace manual procedures.

A SOLUTION

Factors Governing a Decision to Instal Machine Accounting

1. Is there a need? Will the machines:
   (i) improve quality and accuracy;
   (ii) improve internal control;
   (iii) relieve peaks and bottlenecks;
   (iv) reduce cost?
2. Are the expected improvements commensurate with the cost?
3. Can the present method be improved to eliminate weaknesses without using mechanical methods?
4. Do the contemplated costs and methods include:
   (i) training costs and extra supervision required for the installation;
   (ii) preparatory work, not previously considered a part of the routine, which will be required on the part of workers;
   (iii) a system designed to accommodate the exceptions which occur? (To what extent will these exceptions nullify the effectiveness of the new method and what effect will they have on costs?)

5. What additional reports or statistics are being produced? Is there a real need for them or are they fringe reports?
6. What marginal jobs are being included in the arguments put forward to justify acquisition of the equipment? Are these jobs sound applications for the new equipment, or can they be handled better or at less cost in some other manner?
7. What effect will mechanization and production-line techniques have upon the morale of the organization?
8. Are trained operators available in sufficient quantity and quality to meet the organization's normal selection standards?
9. How will the proposed changes fit into the long-term needs of the organization?
10. Will the use of accounting machines lead to speedier preparation of the financial statements?
11. How frequent and serious are machine breakdowns likely to be? What sort of delay is normally caused by repairs?
12. Are servicing and repairs readily available?
13. How can the company finance the acquisition of the machines?
14. What has been the experience of other similar businesses? Should the company obtain a systems survey?

PROBLEM 2

Final Examination, October 1957

Auditing I, Question 5 (20 marks)

The accountant of M Co. Ltd. has prepared the company's financial statements for the year ended December 31, 1956. On reviewing these statements, CA, the shareholder's auditor, notes the following abnormal conditions reflected therein:

(i) The percentage of gross profit on net sales was considerably in excess of what it had been in previous years.

(ii) The rate of turnover of average monthly inventory was unusually low in comparison to previous years.

(iii) The accounts receivable outstanding at the year end represent an unusually high number of average day's credit sales.

(iv) The inventories on hand at the year end represent an unusually high proportion of the current assets.

(v) The working capital ratio is almost twice what it was in 1955.

Required:

(6 marks) (a) What possible fraudulent actions or inconsistent accounting applications are indicated by the above abnormalities operating together?

(14 marks) (b) Under such circumstances, what extension to and alterations of the usual audit procedures should CA undertake?

A SOLUTION

(a) Possible Fraudulent Actions or Inconsistent Accounting Applications

1. Sales for the year and accounts receivable at the year-end have been overstated by the inclusion of fictitious invoices. The unusually high percentage of gross profit on net sales, the unusually high number of average days' credit sales outstanding, and the unusually high working capital ratio all support the supposition of fictitious sales.
2. Inventories have been overstated in some way. The unusually high working capital ratio, the unusually high percentage of finished goods inventory in current assets, and the low turnover rate of average monthly inventories all tend to support the supposition of manipulation of stock figures.
3. Inconsistencies or errors in the year-end cut-off for both purchases and sales. The unusually high percentage of gross profit on net sales, the unusually high number of average days' credit sales outstanding, and the unusually high proportion of finished goods inventory in current assets indicate the possibility of irregularities in the year-end cut-off procedures.
4. A change in the method of determining the cost of year-end inventories. Such a change might explain the low turnover rate and the high proportion of finished goods inventory in current assets.
5. An insufficient allowance for obsolete and damaged merchandise in the year-end inventories.

(b) Recommended Extension to and Alterations of Usual Audit Procedures

1. *Accounts receivable*
   Extend the confirmation of outstanding accounts to a positive confirmation of all accounts.
2. *Year-end cut-off*
   (i) Extend year-end cut-off procedures to a detailed checking of all sales and purchases within the last few weeks of the year and the first few weeks of the following year.
   (ii) Check all deliveries in this period to sales invoices and clear deliveries to physical inventory records and perpetual inventory records to make sure that invoices are not being made out for goods delivered before the year-end with the stock concerned still being included in inventories at the year-end date.
   (iii) Clear all sales invoices and all delivery receipts for selected periods.
   (iv) Check all receiving slips in the period to purchase payments or accounts payable and to inventory records and physical inventory records to make sure that no goods are included in inventories for which the liability has not been set up at the year-end date.
3. *Year-end inventories*
   (i) Extend the usual procedures from a testing basis to a complete checking.
   (ii) Check all items in finished goods inventories from the physical count sheets and from the perpetual records, if any.

(iii) Check all prices and calculate all extensions. Check to make sure that the basis of pricing is consistent with that of prior years.

(iv) Pay particular attention to the possibility of the inclusion of non-existent items or items which have been sold but not delivered at the balance sheet date, and to the possibility of items being included in inventory twice.

(v) Enquire from officials of the company whether there are any reasons why stock figures should be higher than in previous years.

4. *Sales*

(i) Extend tests of sales invoices and credit notes beyond the usual basis. Scrutinize sales invoices for the whole year and compare unusually large invoices with delivery dockets and check them as to prices and extensions.

(ii) In scrutinizing sales invoices, watch for sales of fixed assets included with credit sales or sales of items which are not of the same type as the company's products.

(iii) Check all credit notes early in the subsequent period to make sure that fictitious sales near the end of the period have not been cancelled by fictitious credit notes early in the subsequent period.

(iv) Test check sales invoices to orders received.

(v) Scrutinize the accounts receivable ledger for accounts in which there have been an unusually high number of credit sales.

5. *Purchases*

(i) Extend test of purchases and tracing of purchases to perpetual inventory records. Scrutinize invoices to make sure that purchases have not been understated by the suppression of invoices or the recording of fictitious returns.

(ii) Check carefully all purchases not charged to raw materials to make sure that they have been correctly allocated and do not, in effect, represent raw material purchases.

(iii) Confirm accounts payable.

Examiner's Comments

Many candidates considered the abnormalities separately instead of dealing with them as a group, as the question required.

PROBLEM 3

Final Examination, October 1957

Auditing II, Question 1 (12 marks)

The ultimate objective of independent auditing activities is the auditor's expression of opinion as to whether the financial statements upon which he is reporting are properly drawn up so as to exhibit a true and correct view of the state of his client's affairs and the results of the operations. Depending upon his findings, the auditor may express either a qualified or an unqualified opinion, or he may disclaim an opinion.

Required:

Under what circumstances would a chartered accountant be justified in:

(a) Expressing an unqualified opinion?
(b) Expressing a qualified opinion?
(c) Disclaiming an opinion?

A SOLUTION

(a) A chartered accountant would be justified in expressing an unqualified opinion when, as a result of his examination, he is satisfied that the financial statements present a true and correct picture of the financial position and operating results, and that no material errors or deliberate misstatements exist which would preclude his expressing an opinion. He must be satisfied in all material respects and have adequate grounds for his opinion.

(b) A chartered accountant would be justified in expressing a qualified opinion when he believes that the statements are a generally fair presentation but has not been completely satisfied on some point or feels that some part of the financial position or results of operations is not fairly presented. In expressing a qualified opinion, he should indicate the nature of his reservation or exception. In general, the necessity for expressing a qualified opinion occurs when the chartered accountant was not permitted or was otherwise unable to make an examination sufficiently complete to warrant the expression of an unqualified opinion, or when he has found departures from accepted accounting principles which the company is unwilling to correct.

(c) A chartered accountant should not express an opinion that the financial statements present fairly the financial position and results of operations when his exceptions are such as to negative the opinion, or when the examination has been less in scope than he considers necessary to express an opinion on the statements taken as a whole. In such circumstances, whenever a chartered accountant permits his name to be associated with the financial statements, he should state that he is not in a position to express an opinion on the statements taken as a whole and should indicate clearly his reasons therefor.

Examiner's Comments

Many candidates gave only a partial answer because they gave specific examples instead of setting out the general principles involved.

PROBLEM 4

Final Examination, October 1957

Auditing II, Question 2 (10 marks)

During the course of his examination of the accounts of L Co. Ltd. for the year ended June 30, 1957, CA, the shareholders' auditor, discovers the following journal entry:

Dr. Buildings and equipment	$152,400	
Cr. Earnings retained for use in business		$131,600
Cr. Accumulated depreciation		20,800

On investigation, CA finds that, in April 1957, the company received a notice of assessment from the income tax authorities for the year ended June 30, 1956. A substantial proportion of the expenditures relating to the company's fixed assets claimed as current expenses had been disallowed as a deduction from income and was instead added to the appropriate fixed asset account upon which capital cost allowance was allowed. The company's appeal of this assessment was unsuccessful.

The amount charged as current expense in 1956 had been substantially higher than in previous years in view of major alterations in the company's operating facilities undertaken in 1956. However, it had been determined on a basis consistent with the company's established policy of apportioning current expenditures between capital expenditures and current repairs and maintenance. This plan had never before been questioned by the tax authorities and had been approved by CA as acceptable accounting practice.

The directors explained that, because the tax authorities had disallowed $152,400 of the repairs and maintenance expense, it was decided to capitalize the equivalent amount and to take depreciation thereon.

Required:

Discuss the propriety of the directors' action.

A SOLUTION

Only the actual additional tax need be recorded on the accounts. The journal entry authorized by the directors should not have been made for the following reasons:

(1) The original treatment of charging alterations to current expense conformed to accepted accounting practice and was consistent with established company policy. In adjusting the accounts, the directors are no longer conforming to company policy and accepted principles, but are attempting to distinguish in the accounts between capital and revenue expenditures according to income tax law.

(2) It is not advisable to reverse established and accepted procedures merely because the income tax position is different. The income tax rulings have no real relation to the company's accounting techniques. Proper accounting to arrive at profit and the methods used to arrive at taxable income are often at variance and the purpose of business is to lead the taxing authorities in matters of this sort rather than to follow them, which is evidence of defeat.

(3) Capital cost allowance may be deducted for tax purposes in subsequent years without classifying the costs in question as fixed assets in the books. It is therefore unnecessary to disturb the consistent and proper accounting methods already in use.

(4) By recording the disallowed expenses as a fixed asset, the accounts for the year are not consistent with prior practice and the effect of current and subsequent depreciation written in the accounts will upset current and future comparisons.

Examiner's Comments

A number of candidates discussed at length the deferment of income taxes paid, as recommended by C.I.C.A. Bulletin No. 10.

PROBLEM 5

Final Examination, October 1957

Auditing II, Question 3 (15 marks)

CA is the auditor of R Co. Ltd., a medium sized company engaged in the distribution of hardware. Q, the former sales manager of the company, who has just been appointed president, writes CA the following letter:

Dear Mr. CA:

As auditor of our company, would you be good enough to take on a special assignment for me?

You are no doubt aware that I have hitherto been in the sales end of our organization and have just taken on added responsibilities with my appointment as president. Naturally, I have never had any direct concern with the financial and accounting side of the business. So far as I know, this part of our operations has always seemed to run satisfactorily. However, I would like you to make a general survey of our accounting system so that you can report to me if there is anything seriously wrong. I have in mind a brief review and not a lengthy and detailed report on systems. We are not anxious to make a lot of changes at this time, but I would feel better if I had your assurance that things were reasonably under control.

Yours faithfully,
Q
President.

On receipt of this letter, CA arranges for a general review of the accounting system. During the course of the review, the senior in charge of this work prepares the following notes:

(i) *Cash count on surprise basis.* Petty cash short $12.85. Spent time on reconciliation as custodian does not keep up to date. Old trouble we have often reported on. Probably should increase fund as frequent reimbursing cheques needed — better still, cut down on number of things paid in cash.

(ii) *Chief accounting officer — W, treasurer.* On arrival found him writing up general ledger. Does too much detail.

(iii) *Monthly financial statements.* Usually late (July statement typed September 16). W says volume of routine makes delays inevitable. Monthly statements show excellent detail — probably too much. Question whether used to advantage.

(iv) *Income tax.* Assessed to last year-end.

(v) *Dominion sales tax audit now going on.* Assessor says no serious adjustments discovered yet.

(vi) *Accounts receivable.* We have made no circularization of receivables

for several years owing to client opposition – might be opportune to press now for one.

(vii) *Accounts receivable.* Reviewed company aging, collections appear to be satisfactory.

(viii) *Cash book write-up delayed.* W was ill last week for two days and he opens all mail.

(ix) *Expense vouchers tested.* Month of June. Missing vouchers:

No. 1203, June 3	C.N. Express	$ 83.40
No. 1212, June 6	E Co. Ltd.	149.12
No. 1375, June 19	C.N. Express	12.11
No. 1376, June 10	C.N. Express	8.04
No. 1461, June 28	F Co. Ltd.	844.20

W given above list and will try to locate.

Required:

Write a letter to Q, commenting on the general deficiencies in the accounting system indicated by the above notes.

A SOLUTION

October 7, 1957.

Q.,
President,
R. Co. Ltd.,
Saint John, N.B.

GENERAL SURVEY OF ACCOUNTING SYSTEM

We have completed our review of the accounting system in operation at R Co. Ltd. and report that a generally satisfactory condition exists from the point of view of control. The few errors which came to our attention in the course of the examination were relatively unimportant, and we have noted the prompt clearance of income tax and sales tax. The recommendations which we make below will not require significant changes in the company's organization.

In our opinion, additional effort should be made to organize the accounting detail with a view to overcoming the present delays in preparing monthly financial statements, writing up the cash book, and keeping the petty cash fund up to date. We believe that the solution to the present difficulties in this respect lies in a greater delegation of the accounting work amongst the clerical staff so that the treasurer will not be as much preoccupied with detail, and can concentrate on the supervisory aspect of his position. We have also discussed with the treasurer the various means by which the minor inefficiencies in the current system may be overcome.

We should be glad to have your views about the usefulness of the detailed information currently included in the monthly financial statements. We believe it may be possible to simplify these statements, and yet retain their value for management.

We will be pleased to discuss these matters with you further, and sug-

gest that we might also review at your convenience the scope of our present annual audit program.

Chartered Accountant.

Examiner's Comments

1. The candidates who restricted their comments to the general and pertinent points received the highest marks. Candidates lost marks if they dwelt on petty irrelevancies (such as the cash shortage or missing vouchers) or if they stressed facts which were not really germane to the client's request (such as the tax assessment or the accuracy of the accounts receivable ageing).
2. Some candidates tended to make an audit review rather than a systems review.
3. A number of candidates overlooked the fact that CA was already the company's auditor.

PROBLEM 6

Final Examination, October 1957

Auditing II, Question 4 (17 marks)

CA is the shareholders' auditor of X Co. Ltd., which owns and operates a chain of 15 retail stores. On reviewing the current operating statements of the various stores, CA finds that, while mark-downs on sales averaged 4%, one particular store had mark-downs of 2%. This same store showed shrinkage of 1½% whereas the average shrinkage of the other stores was less than ½%.

Required:

(*5 marks*) (a) List the factors which could have contributed to the abnormal mark-down and to shrinkage of the one store.

(*12 marks*) (b) Outline the procedures that CA should undertake in order to determine the extent to which each such factor actually contributed to the abnormalities in the store's operating results.

A SOLUTION

(a) Factors which could have contributed to the abnormal mark-down and shrinkage

1. All mark-downs were not recorded, or some mark-downs may have been regarded as shrinkage.
2. The retail branch concerned may handle a different type or quality of merchandise, requiring a different pricing policy.
3. Head office instructions relating to mark-downs may not have been followed. A refusal on the part of the manager of the retail branch to reduce prices of slow-moving items might mean that they were left in inventory and eventually regarded as worthless.
4. Merchandise may in fact be being sold at less than authorized prices.
5. The closing inventory for the purpose of determining the shrinkage may have been incorrectly calculated. For example, it may have been calculated at cost instead of retail, obsolete items may have been excluded, or there may have been clerical errors.

6. There may be inadequate supervision of merchandise, permitting pilfering by customers or employees.

(b) Audit procedures to determine cause and extent of abnormalities in store's operating results

1. Check the procedures laid down for controlling the recording of mark-ups and mark-downs.
2. Determine whether the marking of price tags consistently follows the authorized pricing policy, and the method followed in recording changes in price.
3. Check the control over sales to ensure that sales are not being deliberately made at less than cost.
4. Check the manager's record of mark-downs to the inventory control accounts or records.
5. Check all inventory calculations and the basis of pricing.
6. Check the physical control of inventory.
7. Check the percentage of marks-ups compared with other stores.
8. Determine the degree of error, if any, in recording mark-downs and inventory. Any other abnormal shrinkage should be the result of sales at less than the proper price.

PROBLEM 7

Final Examination, October 1957

Auditing II, Question 5 (12 marks)

CA is auditor of a large manufacturing company with five factories across Canada. In October 1956 the directors advise that they wish to obtain the audited financial statements for the year ended December 31, 1956 by the end of January 1957 as they must do some important refinancing by that date.

Required:

(*6 marks*) (a) What steps should CA suggest that his client undertake in order to speed up the year-end close-off of the accounts?

(*6 marks*) (b) What steps could CA take to expedite his year-end audit?

A SOLUTION

(a) Steps that the client should undertake to speed up the year end close-off of accounts

1. Physical inventory taking should be completed before November 30, which is satisfactory with good internal control.
2. A schedule of deadlines for each plant should be worked out and figures should be wired in to head office if necessary (and confirmed later by post).
3. All questions of year-end adjustment should be reviewed in advance and discussed with the auditors, so that only those decisions which cannot be made in advance are left until January.
4. Each department should be advised of its share in the preparation of statements and a realistic deadline set for completion of the work.

5. If one or more of the plants or branches is small, consideration may be given to its closing on, say, December 24 with no more shipments or sales to be reported.
6. Branches should be advised to try to avoid cash and inventory transfers near the end of December, with a view to minimizing problems related to cut-off.
7. The client should send letters to suppliers requesting that they forward invoices and statements as soon as possible after December 31.

(b) Steps which CA should take to expedite his year-end audit

1. Do as much test work as possible prior to the year-end. Bring analyses up to the interim date.
2. Plan staff requirements in advance so that proper staff will be available for the audit in January. Assign some members of staff to the advance drafting of working papers, such as statement assembly sheets.
3. Discuss policy considerations in advance.
4. If the physical inventory was taken on, say, November 30, perform inventory verification prior to December 31. Test confirm accounts payable at November 30 instead of December 31.
5. Circularize and age accounts receivable at some date prior to year-end.
6. Ascertain the reasons for the intended refinancing, and prior to December 31 review with the client its possible effect on the financial statements.

PROBLEM 8

Final Examination, October 1957

Accounting II, Question 5 (12 marks)

In recent years, an increasing number of public limited companies have adopted the practice of providing shareholders with semi-annual or quarterly reports in addition to the annual report.

Required:

(*8 marks*) (a) Outline the advantages of this practice from the viewpoint of:

(i) management of the company,
(ii) shareholders of the company,
(iii) investing public generally.

(*4 marks*) (b) What arguments might be advanced against the more general acceptance of the practice of interim reporting?

A SOLUTION

(a) **Advantages of Semi-Annual or Quarterly Reports**

(i) *For management*

(1) Interim reports are a means of demonstrating that management recognizes the position and rights of shareholders and is accepting responsibility for advising them of actions taken in the administration of the company's affairs.

(2) Interim reports permit shareholders to learn more about the company and help them to understand and appreciate the problems of management.
(3) Frequent reporting improves the public relations of the company by supplying financial publications with up-to-date information.
(4) A good system of accounting must be maintained to provide the required information quickly, and in the result management is kept better informed.

(ii) *For shareholders*
(1) Interim reports keep shareholders up to date on the current trends in their investment.
(2) Shareholders are more likely to have confidence in the management if they are given information over and above the minimum legal requirements of annual reporting.
(3) The frequent circulation of financial data and accompanying explanations help shareholders to assess the formal accounts submitted at the year end in the annual report.
(4) Interim statements help to stabilize the stock market prices of the company's shares and improve their marketability.

(iii) *For the investing public generally*
(1) Financial information released at regular intervals during the business year enables a more reliable valuation to be placed on the company's shares.
(2) If the company's performance is good, frequent reporting will help to create a receptive market for the company's securities. If, on the other hand, the company's performance is disappointing, interim reports which offer an explanation and state the remedial actions proposed or taken by management may help to prevent permanent damage to the market for the company's stock.
(3) Interim statements for a group of companies may, in the aggregate, provide an up-to-date indication of the state of an industry, or of the whole economy.

(b) Arguments Against Interim Reporting
(1) Accounting data are less precise for short periods. Unless carefully explained, seasonal fluctuations may make the figures misleading.
(2) Preparation and distribution of interim statements is costly.
(3) Competitors may be given information that would be useful to them.
(4) Being unaudited, interim statements may be incorrect and therefore misleading both to shareholders and to the investing public. If the final audited accounts are different, management may not be as cooperative with the auditor in resolving points of disagreement.

Examiner's Comments

Many students have not mastered the technique of listing points with brief explanations. Instead, they tend to write long rambling paragraphs in which one or two points may be imbedded, but the length of which brings them no extra marks.

NEWS OF OUR MEMBERS

Alberta

Moran, Fenton, Bliss & Co., Chartered Accountants, announce the dissolution of their partnership. Henceforth E. Mainwood, S. W. Andrew, J. D. Moran and E. C. Fenton will carry on the practice of their profession under the firm name of Moran, Fenton, Mainwood, Andrew & Co., Chartered Accountants, with offices at 353 –11th Ave., S.W., Calgary.

F. H. Tippitt, C.A. has been appointed controller and assistant secretary-treasurer of O.K. Construction Ltd., Edmonton.

British Columbia

Ian Kennedy, C.A. has been appointed controller of Okanagan Helicopters Ltd. (The Okanagan Group).

A. J. Shankland & Co., Chartered Accountants, Cranbrook, announce the admission to partnership of James William Kraft, C.A.

Rickard, Crawford & Co., Chartered Accountants, announce the opening of an office for the practice of their profession at 277 Cumberland Rd., Courtenay.

Nova Scotia

Reginald D. Evans, C.A. has been elected a director and treasurer of Farmers Ltd., Halifax.

Barrow, Nicoll & Co., Chartered Accountants, Halifax, announce the admission to partnership of John R. Kaulbach, C.A., and Lynn E. Corkum, C.A.

Ontario

Allen W. Ballet, C.A. announces the opening of an office for the practice of his profession at 14 Queen St., St. Catharines.

David B. Fine, C.A. announces the admission to partnership of Carl Laywine, C.A. Henceforth the practice of their profession will be carried on under the firm name of Fine, Laywine & Co., Chartered Accountants, with offices at 154 University Ave., Toronto.

Magee & Palin, Chartered Accountants, announce the dissolution of their partnership. Henceforth the practice will be carried on by Gordon W. Palin, C.A., with offices at 2231 Bloor St. W., Toronto.

John H. Charnock, C.A. announces the opening of an office for the practice of his profession at 21 Cooper Bldg., Fort William.

D. A. Rumgay, C.A. has been appointed vice-president and general manager of Aeroquip (Canada) Ltd., Toronto.

A. E. Stead, C.A. has been appointed associate secretary of Chartered Trust Co., Toronto.

W. I. Hetherington, F.C.A. of Gunn, Roberts & Co., and past president of the Institute of Chartered Accountants of Ontario addressed the Canadian Independent Adjusters at their two day national conference held in Toronto in June. The conference was attended by over 300 delegates and the subject of Mr. Hetherington's paper was "Problems of a Service Business".

Redfern, Murray & Co., Chartered Accountants, announce the removal of their office to 71 Broadway St., Tillsonburg.

D. W. Turnbull, C.A. has been appointed a vice-president of Foster Advertising Ltd., Toronto.

A. John Cheney, C.A., Gordon E. Glenn,

B.Com., C.A. and John M. Graydon, C.A. announce the formation of a partnership for the practice of their profession under the firm name of Cheney, Glenn & Graydon, Chartered Accountants, with offices at 91 Colborne St. E., Oakville.

Bruce C. Willis, C.A. has joined Payne-Ross Ltd., as a principal and will be associated with the firm's Montreal office.

Quebec

John W. E. Brown, C.A. has been elected to the Board of Directors and appointed comptroller of Pepsi-Cola Co. of Canada Ltd., Montreal.

Benjamin Stokes, C.A. has been appointed secretary-treasurer of Ciba Co. Ltd., Montreal.

Saskatchewan

R. L. Bamford & Co., Chartered Accountants and McCartney & Marsh, Chartered Accountants, announce the merger of their practices. Henceforth the practice of their profession will be carried on under the name of R. L. Bamford & Co., Chartered Accountants, with offices at Ste. 502 Scott Bldg., Moose Jaw and branch offices at Assiniboia, Estevan & Weyburn.

OBITUARY

We regret to announce the death of the following member:

WALKER H. H. SAVAGE — On June 19th, 1958 at the age of 74 years. He was born in London, Ontario, but was educated in Montreal. He was admitted to both the Ontario and Quebec Institutes in 1923 and for 35 years was senior partner of Walker H. H. Savage & Co., Montreal. Until his retirement last February, Mr. Savage had been sole auditor of the Synod of Christ Church Cathedral.

INSTITUTE NOTES

B.C. INSTITUTE

C.A. Club of Vancouver: Dr. R. H. Wright, Head of the Division of Chemistry of the B.C. Research Council, addressed a luncheon gathering of the Club on August 4, 1958. Dr. Wright emphasized the vital importance of industrial research in insuring that through a program of continuous improvement and development, B.C. products maintain a position of supremacy in competitive markets.

$50 Canada Savings Bonds have been a feature of membership draws at the last two luncheon meetings. Draw winners to date include R. M. Freedman of Westcoast Transmission Co. Ltd., and C. D. Yeomans of Scoffham, Yeomans & Co.

Appraisal Program: E. C. Mapson (Chairman), H. H. Adair and P. W. Crawford have been appointed to the board of appraisers to review offices of members employing articled clerks.

C.A. Wives Club — Cotton Dance: A capacity crowd attended the C.A. Wives Club Cotton Dance held at Canyon Gardens, North Vancouver on July 11, 1958.

ONTARIO INSTITUTE

Affiliates: The following applicants have been admitted to membership by affiliation: V. Houghton (Que. '41), D. J. Kelsey (B.C. '47), W. G. E. Lannaman (Eng. '37), I. F. Markson (Scot. '56), C. P. New-

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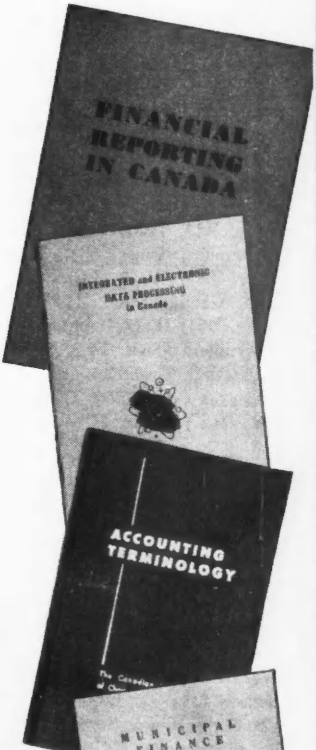

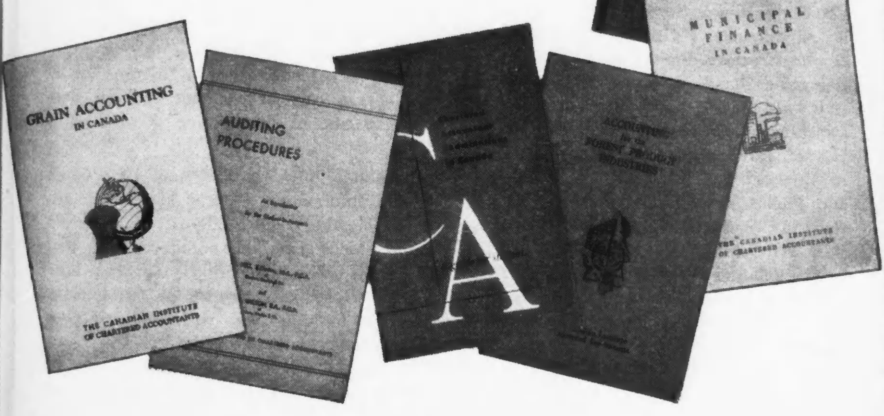

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bound (Inc. '57), J. L. Rubinovich (Que. '56), D. C. Scott (Eng. '54), J. R. Steinhoff (Man. '37), Que. '42, N.S. '53), R. P. Sutherland (Scot. '54), K. F. Baldwin (Eng. '54), J. D. ffolliott (Inc. '57), W. E. Goodlet (Scot. '53), D. H. Jones (B.C. '56), B. d'Arcy Leitch (Ire. '49), D. L. Magowan (Ire. '57), L. N. Rapley (Inc. '56), D. A. White (Inc. '52), H. G. Barrier (Que. '56), G. M. Colley (Man. '53), S. A. G. Gray (Scot. '53), R. L. Jones (Eng. '50), I. Nyman (Eng. '58), R. V. Ratcliff (Eng. '50), B. Robson (Eng. '56), A. C. Rooney (Que. '44), W. R. Simpson (Scot. '41), L. J. Skaife (Que. '26), W. Steuerman (Eng. '56), K. A. Harding (Eng. '58), W. R. Lochhead (Scot. '51), A. K. MacRae (Que. '41), P. C. Monachan (Scot. '56), H. O. Newman (Eng. '50), R. F. Winfield (Scot. '37), H. W. Allen (Ire. '48), R. P. Grantham-Hill (Eng. '56), H. E. Hayes (Eng. '53), C. J. Parsons (Eng. '55), and J. Smart (Que. '47).

Library: A revised library catalogue was sent to all members in early August. The sections of the library have been expanded to include literature on accountancy bodies, examinations and instruction, statutes and tax services. Books recently purchased are as follows: "Financial Aspects of Health Insurance" by M. G. Taylor; Canadian Tax Foundation. "Complete Plain Words" by E. Gowers: Her Majesty's Stationery Office. "Disposition of a C.P.A.'s Practice": Illinois Society of Certified Public Accountants. "Other People's Money"; D. R. Cressey: Free Press. "Accounting Reporting Standards for Corporate Financial Statements": American Accounting Association. "Professional Ethics", D. V. House: Institute of Chartered Accountants in England and Wales. "Canadian Sales and Excise Tax Guide 1957-58 (7th Edition)": Commerce Clearing House. "Practical Manual of Organization", R. E. Gillmor: Funk and Wagnalls. "Electronic Computers for Business Data Processing": J. D. Woods and Gordon Ltd. "Electronic Computers and Management Control" G. Kozmetsky and P. Kircher: McGraw Hill and Company.

Major Medical Plan: In July, members, students-in-accounts and employees of practising members were offered a hospital, surgical, medical plan underwritten by the Continental Casualty Company and administered by United Casualty Agencies Limited, 696 Yonge Street, Toronto. The plan is designed to provide complete coverage until January 1, 1959 at which time the premiums and coverage are limited to conform with the Ontario Hospital Services Commission Act. The plan has been approved by the Council and replaces the previous plan which will terminate on September 15, 1958. For those subscribing, benefits are available up to $5,000 in any calendar year and include coverage of hospital, surgical, nursing and drug expenses.

Group Income Protection Plan: In addition to the Major Medical Plan, members who are not already participating are being given an opportunity to enroll in the Group Income Protection Plan during the period July 15 to September 15, 1958. This plan has been in operation since 1950 and provides monthly income for members disabled by accident or sickness. There is also provision for a principal sum where permanent disability occurs through an accident. Because of the exceptionally low loss ratio the Continental Casualty Company has redeclared the dividends previously in force which increase the amount of the indemnity by as much as 25% for members under 40 years of age. There is also an optional long-term benefit which is available to members under 55 whereby the monthly income is extended for the lifetime of a member in case of accident and for five years in case of sickness.

Information Booklet: The June 1958 issue of the Information Booklet has been sent to all members and students. It gives in detail the registration, enrolment and examination requirements of the Institute. The final date for registration is October 22, 1958 for those who wish to enroll in a course of instruction for the 1958-59 year. The booklet announces the imposition of a $15.00 late filing fee for examination ap-

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plications and an increase in the fees for each of the examinations except Economics.

University of Toronto Administrative Development Courses: The Institute of Business Administration of the University of Toronto is again offering a variety of evening courses at the graduate level for business executives and supervisors. The courses begin in the middle of October and end in March with a three-week break from mid-December to early January. The courses include Administration, Financial Management, Marketing, Production, Human Relations, Industrial Relations, Personnel Administration and Operational Research.

Council Election: Members elected to the Council of the Institute at the annual meeting on June 16 were: W. J. Ayers, J. W. Bennett, M. A. Bradshaw, J. F. Broadhead, J. G. Brown, L. C. Crawford, R. B. Dale-Harris, C. F. Gaviller, J. W. Glendinning, D. L. Gordon, J. W. Grant, W. I. Hetherington, T. C. Kinnear, W. G. Leonard, G. A. MacDougall, A. S. Merrikin, J. A. Orr, G. H. Spence, W. G. Thompson and D. Vise.

QUEBEC INSTITUTE

Council Meeting: As in previous years the August meeting of the Quebec Institute Council was held in Quebec City, this year on Monday, August 12. Attending from Montreal were G. F. Abbott, F. V. Anderson, R. Charbonneau, A. M. Henderson, G. P. Keeping, A. G. Leroux, B. G. Levine, J. F. Lewis, H. I. Ross and C. D. Mellor, as well as past presidents A. Ballantyne, J. A. deLalanne, C. N. Knowles, P. F. Seymour and J. C. Thompson.

While in Quebec, the party were guests of the Quebec City Committee. Following the meeting, Godfrey Gourdeau presided at luncheon and then the Quebec City Committee played a golf match with council members. The Montreal representatives travelled to and from Quebec via Canada Steamship Lines.

Golf Day: The golf day for Quebec Institute members is Monday, September 22. Members will compete over the manicured fairways and greens of the Ilesmere Golf Club and will have dinner in the new clubhouse. Those participating in the McDonald cup competition will play at the Rosemere Golf Club, Rosemere, Que., also on September 22. They will join with the others for dinner at Ilesmere.

CLASSIFIED ADVERTISEMENTS

All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario

Closing date is 13th of preceding month

ACCOUNTING PRACTICE WANTED: A small or medium sized practice preferably in the Oakville district desired through direct purchase or association with practitioner contemplating retirement. All replies considered. Box 805.

ACCOUNTING PRACTICE WANTED in Montreal by purchase or succession agreement. Box 766.

LONDON CHARTERED ACCOUNTANTS with Overseas associated firms outside America would like to hear from qualified accountants in the United States and Canada with view to considering formation of associated firms based on various centres of United States and/or Canada, and London; London principals used to conduct of European matters; partner contemplating visiting United States and Canada; discussions with principals visiting London would be welcomed. Replies would be treated in strictest confidence. Write Box JA. 568 c/o 191, Gresham House, London, E.C. 2, England.

LATIN AMERICA: Career Opportunities for Experienced Accountants in Venezuela and certain other Latin American countries. International public accounting firm seeks capable candidates, single or married, with a minimum of three years public accounting experience. Contracts are generally for two or three years and are renewable by mutual agreement. Attractive compensation combined with opportunity for advancement. Knowledge of Spanish desirable but not essential.

Please submit complete summary of your qualifications and experience to Box 808.

RECENT GRADUATES WANTED for multi-plant operation in Toronto area. No travelling. Starting salary to $7,000. Reply in strict confidence to Box 800.

THIRD OR FOURTH YEAR STUDENT of partnership calibre wanted by chartered accountant practising in Toronto and vicinity. Give full particulars to Box 802.

ACCOUNTANT WANTED: Recently qualified chartered accountant required by progressive manufacturing industry in Western Ontario for interesting and responsible position. Salary in accordance with qualifications, and excellent prospects. Reply in confidence, giving age, qualifications and salary desired to Box 810.

STUDENTS WANTED: Intermediate and senior, for Wm. Eisenberg & Co. In Toronto call M. Adams at EMpire 3-6304; in Windsor call M. Bernholtz at CLearwater 4-9256.

FOURTH YEAR STUDENT desires position with medium size C.A. firm in Vancouver. Box 803.

ADMINISTRATIVE OFFICER: Young chartered accountant required by large metropolitan Montreal hospital to act as purchasing officer, with a view to assuming a more senior position in either finance or administration. Full employee benefits including pension plan and life assurance. Reply to Box No. 804 enclosing photograph, and giving full details and salary required.

CHARTERED ACCOUNTANT, Bachelor of Commerce degree, municipal and insurance experience requires position in Toronto area. Box 801.

YOUNG CHARTERED ACCOUNTANT seeks employment with C.A. office in Toronto area either on per diem basis or permanent basis with view to partnership. Box 807.

C.A. with 8 years experience; 1 year taxation and 2 years with C.A. firm since graduation, including 1 year foreign service, wishes to return to commerce or C.A. firm in Canada. Box 806.

PART TIME AUDITOR AVAILABLE: Bachelor of Commerce with C.A. degree, age 28, interested in position with auditing firm from November to April on permanent basis. Locate in Toronto or Montreal. Box 809.

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